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Canada
ROYAL COMMISSION
ON
TRANSPORTATION

EVIDENCE HEARD ON

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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, Ontario,
Wednesday, May 24, 1950
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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
WEDNESDAY
MAY 24, 1950

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D., - CHAIRMAN
HAROLD ADAMS INNIS - COMMISSIONER
HENRY FORBES ANGUS - COMMISSIONER

- - - - -
G.R. Hunter
Secretary
- - - - -

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| K.D.M. Spence | | |
| I.D. Sinclair | | |
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| M.A. MacPherson, K.C. |) | Province of Saskatchewan |

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Ottawa, Ontario,
Wednesday, May 24, 1950.

MORNING SESSION

THE CHAIRMAN: Very well, Mr. O'Donnell.

MR O'DONNELL: May it please the Commission:

I think when we adjourned yesterday I was reviewing briefly some of the facts relating to the present-day extent of the operations of the Canadian National and endeavouring to point out the really important place that it holds in the transportation field in Canada.

I had just indicated that it had in 1948, I think, handled 42 per cent more tons of revenue freight than any other transportation agency, railway agency, and had earned about 37 per cent more revenues, and had handled or carried about 47 per cent more passengers than its chief competitor. That is, it handled more than 20 million passengers in 1948; that is some 47 per cent more.

I was pointing those things out by way of substantiation of the statement which will be found in the main brief, Exhibit 214, at page 7, which reads:

"The transportation facilities provided by the Canadian National Railways are by far the most extensive, and few will gainsay that they constitute the single most important agency in the transportation field in Canada today."

Then at page 9 of the brief -- and I do not intend to take much time -- one cannot but be struck by the extent of the work which was done by that railroad during the war, and it also substantiates the statement which I have read.

I mention these facts, as I think I said yesterday just at the close, in passing, so that we may put into proper focus or perspective the real importance of the

Canadian National and of the problem which your Commission has been directed to deal with under the Order in Council.

I now intend to discuss as briefly as possible the financial difficulties of the Canadian National.

Notwithstanding the extensive and really successful railway operations which have been conducted by it since the termination of the war, it has been obliged to report deficits in each year, which aggregate in excess of \$100 million. The reasons for its financial difficulties have been stated, and generally speaking they are threefold. First, the Canadian National is saddled with an excessive capital debt burden, constant or fixed charges, and they are equally real, whether resulting from positive or negative capital obligations, and the expenses and disbursements involved in connection with them.

THE CHAIRMAN: Obligations to whom?

MR O'DONNELL: To the public and to the Government as the holder of these securities.

THE CHAIRMAN: There is, I think, \$580 million---

MR O'DONNELL: \$584 million in the hands of the public.

THE CHAIRMAN: All the rest is in the hands of the Government.

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: And the Government owns the railroads.

MR O'DONNELL: That is right, the Government owns the railroads, and the Government furnishes the money to pay the interest on the bonds that it itself holds, so it is just a matter of running it through the books and running it out again, and in the end result---

THE CHAIRMAN: Isn't there really a merger there?

MR O'DONNELL: Certainly there is.

THE CHAIRMAN: If I owned a farm and bought the mortgage on the farm in, the mortgage is extinguished.

MR O'DONNELL: Well, that would be true possibly if you were the only mortgage holder.

THE CHAIRMAN: I beg your pardon?

MR O'DONNELL: If you were the only mortgage holder, and there were no other people involved.

THE CHAIRMAN: I mean the mortgage that I bought in.

MR O'DONNELL: Yes, as to your mortgage, that is true.

THE CHAIRMAN: It is extinguished.

MR O'DONNELL: Yes.

THE CHAIRMAN: The other \$580 million, of course, to those who hold securities is outstanding.

MR O'DONNELL: That is right.

THE CHAIRMAN: It is a debt that the Government owes to the railway.

MR O'DONNELL: That is right; and whenever the railways has not earned enough to pay the interest, then the Government has had to put the money up, because the Government, after all, is the guarantor, as you will remember, of all those obligations as taken over at the time of amalgamation.

THE CHAIRMAN: But the Government looks to you to earn enough not only to pay the holders of securities, but to pay off themselves.

MR O'DONNELL: Yes; if we do not earn it, then the Government has to vote the deficit solemnly to us, and ultimately its interest is collected in that way, but it has to go through our books, and we have to report a deficit, whereas in effect, our submission is, we should not have to

do that.

THE CHAIRMAN: From something you said yesterday, I thought I gathered that the majority report of the Drayton-Acworth Commission would have obviated that.

MR O'DONNELL: Yes; and your lordship asked me if I knew why they had not done it, and I said I did not know why they had not done it. I could speculate as to why they had not done it. And the position: is -- I would assume this -- in 1919 there was a Coalition Government, and this railroad was set up at that time, and the recommendations of the Drayton-Acworth Commission were substantially enacted. Now, there were some differences. They did not, for instance, carry out the recommendations in full to the letter. Instead of having this perpetuating board of trustees, the bill ultimately enacted set matters up in slightly different form, but substantially they carried out the recommendations of the Drayton-Acworth Commission, except in so far as complying with this recommendation 28:

"We recommend that the Government assume responsibility to the Dominion Railway Company for the interest on the existing securities of the transferred companies."

Now, I might speculate this way, that the Government, as the report clearly points out, was liable and was obliged and would be obliged to take care of those security holders who held the securities which it had guaranteed, and maybe by the time the Act itself became effective and amalgamation became effective in 1923 money might have been a little harder to come by.

(Page 23788 follows)

There was a change, I think, in the situation, and a recession at that time, and in the final analysis it didn't make any difference to the Government. The Government owed the money and the Government had to take care of the interest on those things, and why they didn't clean the situation up at that time I don't know exactly. But I say that on . reading the Drayton-Acworth report, one must come to the inevitable conclusion that the reason the Commissioners said, one of the reasons the Commissioners said, that the bankruptcy proceedings could not be resorted to, was that the credit of Canada and the provinces which had guaranteed these securities, could not be impugned, or its credit could not be destroyed, by allowing these . roads to go into bankruptcy; and that the Government, as guarantor of the obligations really owed the money and would have to take care of the investments. That is made clear by the remarks of the then Minister of Railways, Mr. J. D. Read on 23rd April, 1919 when the bill was being debated, and he said in part this:-

"It is true that the Government will have to look after the bonds outstanding and see that every care is taken in the protection of the investment although it did not itself borrow the money."

Further on there are other similar remarks to that effect, that there was no doubt in the mind of the Government that the Government owed the money. It just occurs to me that insofar as it went at the time, it was six to one and half a dozen to the other, except that in the end result the C.N.R. Railway Company has had to carry through its books these amounts with the interest and has had the stigma which attaches to a

default each time it has not earned its money, and the deficit is reported; but in the end it is the Government who has to provide the money. The Government owes the money and instead of letting these companies go through bankruptcy, as they would have gone had merely private people been operating them, and had their assets -- or, rather, if a re-organization was made which would put them on a proper basis, by reason of what it would have done to Canada's credit insofar as the holders of ^{the} securities, in England, the United States and elsewhere were concerned -- that was not done, and the Commissioners said: "Now, what we recommend in lieu of that is the formation of a new company, a public authority, which will be the Dominion Railway Company, and we recommend that the Government pay the interest on these outstanding obligations."

COMMISSIONER ANGUS: At the period during which you said a few minutes ago, the C.N.R. was obliged to report deficits, that was really the period before the Government had bought in part of the mortgage, isn't it?

MR. O'DONNELL: Well, the Government obtained control or was in control, in charge of the Grand Trunk Pacific through the receiver and had acquired the Canadian Northern in 1918 and had acquired the capital stock of the Grand Trunk in 1920. It was with this array of roads that were bankrupt that it had to deal; and it was in that connection, I think, that the Drayton-Acworth Commission was set up and it looked at the Grand Trunk and the Grand Trunk Pacific situation as well as the Canadian Northern, and their recommendation 23 was:-

"We do not recommend that the Grand
Trunk, the Grand Trunk Pacific and the

Canadian Northern Companies be allowed to go into the hands of a receiver."

Then at different places in the report, which I am sure the Commission knows far better than I, they recommend that these roads be operated as an entity, and ultimately they entrust the Government Railways as such to it as well, that is the Intercolonial and the National Transcontinental and those others.

THE CHAIRMAN: Now, you are talking of all these companies?

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: You took over the roads. What became of the companies themselves?

MR. O'DONNELL: Well, in some cases we have a stock control, and I gave your lordship a brief resume of the situation which will be found in Vol. 109 at page 20026, where we tried to summarize that situation so that it would be clearly understood and seen. I think your lordship will find there in complete detail the array of companies, the constituent companies. We have given there, my lord, and also in the main brief at page 13 and following, quite a complete resume of exactly what transpired. Then we also furnished the Commission with the supporting Orders-in-Council.

THE CHAIRMAN: Where in the Brief is it?

MR. O'DONNELL: At page 13 and following, my lord. I will be glad to run through that summary.

THE CHAIRMAN: No, I don't think so.

MR. O'DONNELL: I think it is all there.

THE CHAIRMAN: You refer to your historical outline.

MR. O'DONNELL: Yes, my lord, and then I have

had the - -

THE CHAIRMAN: I was just wondering for a moment whether the companies themselves as distinct from the property are still in existence.

MR. O'DONNELL: Some of them are, all except the Grand Trunk.

THE CHAIRMAN: Those that are not, how do they - -

MR. O'DONNELL: Well, we include them. You see a reference to them in the annual report. There is a list of the companies in the annual report, and you will remember that we report our activities in consolidated form in this report. But in Exhibit 217 on page 23, one will see the list of the companies, the capital stocks which are owned by the system or by the public.

THE CHAIRMAN: Are they still in existence?

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: And the Government owns all the capital stock?

MR. O'DONNELL: Owns all the capital stock of the Canadian National Railway Company, and the Canadian National Railway Company owns these other companies.

THE CHAIRMAN: That is Exhibit what?

MR. O'DONNELL: That is Exhibit 217, my lord, page 23, that is the Annual report for 1948. I think, my lord, I had just said that the financial difficulties were generally speaking three fold: that, first, the Canadian National had been saddled with excessive capital debt burden, constant or fixed charges, whether resulting from positive or negative capital obligations, and the expenses and disbursements involved in connection therewith: secondly, the Canadian National is obliged in the public interest

to operate without compensation as a matter of national policy and as an instrument of national development, considerable mileage of marginal or non-paying lines; and, thirdly, the third financial difficulty in part, is the imbalance between railway rates and railway costs of labour and materials, which in recent years have not kept pace the one with the other.

Now, with respect to the imbalance between railway rates and costs, while it is true that to some extent the losses experienced in the years since the war have been due to this imbalance, that is but one of the factors contributing to the Canadian National Railways' financial difficulties.

(Page 23793 follows)

And the Board of Transport Commissioners for Canada, of course, is the body, the authority designated by Parliament to determine rates and tolls and we refer to this subject in passing because it indicates only some of the financial difficulties of the road and our view is that admittedly that is a temporary feature and it must be and it is assumed that the Board of Transport Commissioners will under the fulfillment of their duties under the Railway Act provide for the establishment of just and reasonable rates for the services rendered by the railway. And your lordship and the Commission will remember that the Canadian National Railways plan is predicated on that very assumption, that the imbalance between costs and freight rates will be removed..

Now, that is taken into consideration when we put forward our proposal.

THE CHAIRMAN: The unbalance between what?

MR. O'DONNELL: The imbalance between freight rates and cost of operation. These freight rate increase cases have resulted from that situation and our assumption is, and we think it a valid one, that that imbalance has ultimately to be justified. There has been an increase of 40.68%, I think, in freight rates since 1946 and there is an application pending for an additional, roughly 4% which is to be adjudicated upon tomorrow morning, as a matter of fact, but our assumption and our plan is based on that assumption that that imbalance will be removed so insofar as that aspect of the deficit situation is concerned it is to be taken care of and treated like every other railway in Canada in that respect.

But the other two things are the important ones insofar as we are concerned. That is the excessive Debt burden and the operation of these lines in the public interest without adequate compensation or no compensation in most cases.

Now, accordingly, I will direct my argument to these two points other than the matter of freight rates. Now, at this point I wish to emphasize that the revision of the capital structure of the Canadian National as proposed to this Commission is a matter quite distinct and

altogether apart from any matter of rate making for the determination of rates and tolls. That, I submit, is important. These two subjects, the matter of rate-making and the matter of the adjustment of the Canadian National Railway's capital structure are things apart, things distinct. Each, in my submission, must be treated on its own merits and upon a different approach and under altogether different sets of rules.

From the reorganization point of view, the question mainly is how much can an enterprise earn. From the other, or the rate-making point of view, the question is how much will the enterprise be prepared to earn. Two entirely different matters.

Now, the latter question, the rate-making point of view, is sometimes answered upon the basis, among other factors, of a determination of the proper valuation of the property, of the enterprise used and useful which is placed at the disposal of the public which is to be served, but that is a matter altogether different from what I respectfully submit we are putting to this Commission by way of the adjustment of our capital structure.

The Commission, under the Order in Council, is directed to review the capital structure of the Canadian National and on the merits of the Canadian National's own case. Irrespective of what any other railroad may have by way of a capital structure of its own or financial difficulties of its own, this Commission, I respectfully submit, is directed to review and examine the Canadian National situation and I want to say this, that a competitor, I submit,

of the Canadian National or a competitor of any company that is trying to reorganize, cannot be heard to complain on what is strictly a matter of internal adjustment.

The capital structure of any company is that company's affair and that of its shareholders or bondholders having any interest and that is the situation here. Outsiders, as far as I am concerned have no place at a meeting which is determining the capital revision of the set-up of any particular company.

I am satisfied that if the Canadian National Railways, in the event that the Canadian Pacific might, for instance, desire to readjust its capital structure and call a meeting of its bondholders or shareholders to put forward a proposal - that the Canadian National would receive very short consideration if it went into or tried to get into the meeting that would be discussing that matter.

THE CHAIRMAN: But don't you think that the other company is entitled to ask to be protected from the consequences of whatever is done? Supposing that in view of what you are asking us to do your railway finds itself in a new and different position henceforth, then the other railway certainly has the right to ask Parliament to see that it is not driven out of business?

MR. O'DONNELL: I have no objection to them doing that at the proper time and place. I am not suggesting they should not come in here and talk. That is true.

THE CHAIRMAN: You are saying it is not the proper time and place?

MR. O'DONNELL: I am saying it is not the proper time and place. I am saying that the direction of the Commission is to review the capital structure of the Canadian National and I am saying it is a matter of internal house-keeping which has nothing to do with anybody at this stage other than the owner and company officials.

THE CHAIRMAN: What subjects are you dividing the matter into?

MR. O'DONNELL: I am dividing the situation into the rate-making aspect with which I say we are not concerned at all at this point - it is a function of the Board of Transport Commissioners and this Commission is not charged with any duty with respect to that aspect of things. That is something that will have to be dealt with by the Board of Transport Commissioners as and when that matter arises and at this point we are merely dealing with what is a reorganization, so to speak, of the Canadian National Railways itself involving nobody but its owner and itself, in my respectful submission, in law and as and when that company is reorganized it might come to the Board along with others or by itself or others might come to the Board and the rate making function of the Board would go into play at that point and rates would have to be determined ^{mined} as the Board of Transport Commissioners might see fit at that time in view of all the circumstances.

The effect when we get our capital revision as proposed, would have no bearing, in my respectful view, upon what the Board of Transport Commissioners might ultimately do from a rate-making point of view. If the Board of Transport Commissioners continues to fix rates as they have in the past - in the last twenty-five years, whether we have our capital reorganization or not will not make that much difference. If they change, however, to the theory that is suggested by our friends of rate basis at that time, then, our rate base will have to be determined and it will be determined by them under the law and at this point that is quite irrelevant and that is my submission.

THE CHAIRMAN: Are you referring to anything in particular that the Canadian Pacific Railway has put before us so far?

MR. O'DONNELL: I am taking the same position with respect to the Canadian Pacific Railway as they took with respect to the Provinces. They said that they thought the Provinces were intermeddling at one stage or another. I say with respect to this matter, and I say it with deference in respect to them, that they are really intermeddling in our respect at this point.

THE CHAIRMAN: Is that all they are doing? Supposing this Order in Council did not include this provision about your capital structure, would not the Canadian Pacific Railways be entitled just the same to submit amendments to us for consideration, for guidance of the Board?

MR. O'DONNELL: That is true. I have no objection to that at all. I am segregating that from my problem.

THE CHAIRMAN: You do not question their right then to ask us to recommend that the railway Act be amended in certain particulars?

MR. O'DONNELL: No, I do not object to that. All I do object to is this - I say that insofar as they complain of our application --

THE CHAIRMAN: Well, that is a different matter.

MR. O'DONNELL: And of its being treated on a basis other than on its own merits, that I complain of. That is the thing that I say has nothing at this stage to do with them at all and I say their rights so far as rate-making is concerned are not effected by what is done by reason of this proposal because I distinguish between a reorganization and rate-making and I say that the problem - that was the point of my submission, that

these two problems are quite distinct and altogether apart. The application to revise the structure of the Canadian National Railways is in no way concerned with any application to fix rates or to make rates and as and when we are adjusted and go before the Board of Transport Commissioner, then the Board of Transport Commissioners, looking at the overall picture and under its obligation under the law to fix rates that are just and reasonable not for one railway but for all railways, and for shippers and for the public, will take into consideration the overall picture and fix rates.

(Page 23800 follows).

THE CHAIRMAN: I think we would understand you better if you told us now what has occurred so far, ^{or} what has been done so far by the Canadian Pacific before us to which you are objecting.

MR. O'DONNELL: The Canadian Pacific has indicated, in my respectful view, that our capital structure revision is tied into a situation that entails them. I say it is not; that is all.

COMMISSIONER ANGUS: Yesterday the Canadian Pacific advanced a standard of just and reasonable rates that in a sense was not related to your capital structure.

MR. O'DONNELL: That is right.

COMMISSIONER ANGUS: If that standard were accepted, your probable income would be much larger than the income in relation to which you are making your recommendations.

MR. O'DONNELL: That is something that we have a divergence of view on. On the record and on the evidence to which I shall refer later, our attitude and view is that that is not approaching the subject from any point that is realistic at all. The figures mentioned by Mr. Northey ^{were} Jones, \$47,500,000 and \$66,600,000 or \$63,000,000, as he later put it at, in our respectful view,

to make a rate of return that would produce anything like that, is something that is so out of realism that we cannot see that at all. We simply say this, that our capital revision should be considered on its own merits as one company's problem that does not affect its competitor or anybody else at this point. If we go to the Board of Transport Commissioners with this revised capital structure and ask to have rates fixed on that, the shipper or the Canadian Pacific or anybody else may at that point, say that what would give us a rate base on what our capital structure might be would be quite unfair to them.

That may be. But that is a problem that is not before this Commission, in my respectful view.

COMMISSIONER ANGUS: Let us put it this way. If the income asked for by the Canadian Pacific which you consider fantastic were in fact realistic, would you make the same proposals regarding your capital structure?

MR. O'DONNELL: Yes, we would make the same proposal regarding our capital structure because we say the two are not at all related.

COMMISSIONER ANGUS: You mean your capital structure is not related to your probable income?

MR. O'DONNELL: It is not related to the probable income. The income is going to be fixed on the rates as established by the Board of Transport Commissioners, irrespective, I say, of what our problem today of internal housekeeping is. We are entitled to adjust our affairs as a matter between our owners and ourselves, and it has not anything to do with the rates that we hope to get ultimately or can get.

COMMISSIONER ANGUS: Is not your whole case that the fixed charges imposed on you were too great in relation to your probable income?

MR. O'DONNELL: That is right.

COMMISSIONER ANGUS: If your probable income were larger, would they be too great?

MR. O'DONNELL: I say that our fixed charges were too great as imposed on us, that they are altogether out of line with what anybody else's fixed charges are, that they should never have been imposed upon us, that the Drayton-Acworth Commission --

THE CHAIRMAN: Is that not your point?

MR. O'DONNELL: That is the point. That is the basis that we put the case on. They should never have

been imposed on us. It was recommended that the Government should assume the liability for the interest; in fact, the Government has had to pay the interest during the years. It is a government debt. The Government is the owner. The Government is the debtor. The Government is merged in the thing, and it does not make any difference as far as the payment of that interest is concerned, to the Government.

It is
COMMISSIONER ANGUS: too great in relation to your probable income?

MR. O'DONNELL: Too great, income or no income; too great on the earning record.

COMMISSIONER ANGUS: The earning record projected into the future?

MR. O'DONNELL: Yes, and the earning record experienced through the past.

COMMISSIONER ANGUS: Suppose there were some great economies realized from consolidation. Suppose that your net income was caused to rise. Would you still say the capital structure was wrong?

MR. O'DONNELL: I still say that the capital structure as set up should be adjusted. It should never have been imposed on us. That is the basis of my case. At the time of amalgamation those three railroads, bankrupt as they were, would, if they had been privately owned and not had the intervention of the government, been put through bankruptcy and the receiver would have procured for the properties what they would bring in bankruptcy proceedings, which would have been a whole lot less. In fact, the evidence is that the \$804,000,000 of interest-bearing debt would either have been written off or at least would have been made equity, and that is our position. It should not have been anything more, we say, than equity. And in that case the \$34,500,000 of interest that the debt

were allowed to continue to bear and which have been imposed on the Canadian National, would not have been put on in the first instance. That is our position. We simply say today to do what? Recommend that there should be done what the Drayton-Acworth Commission said should be done, adjust the capital structure and remove that obligation which should never have been there. That is all the problem is in its simplest terms at this stage.

THE CHAIRMAN: At the present stage you are simply saying that so long as we are at that part of the problem, it is nobody else's business to interfere and ask us not to do that?

MR. O'DONNELL: Yes, that is all I am saying.

THE CHAIRMAN: That is to say, that it is not the business of the Canadian Pacific to ask us to stop and not to reduce your capital structure.

MR. O'DONNELL: Yes; I say that very frankly.

THE CHAIRMAN: Or to reduce ^{it} only to a certain point.

MR. O'DONNELL: I say that, yes; and in saying that, I say this. It is no more their right to do that with respect to us than it would be our right to do that with respect to them.

THE CHAIRMAN: Have they gone that far?

MR. O'DONNELL: They have gone almost that far. They have said "You must not do this unless you provide concurrently protection for us;" and I simply say that I am not approaching it from the point of view of anything other than an adjustment of my own problem; and my own problem I am entitled, under the direction to the Commission, to have the Commission judge on its own merits.

THE CHAIRMAN: That is so. But suppose it is judged on its own merits and everything that you ask for is granted -- just suppose that.

MR. O'DONNELL: Yes?

THE CHAIRMAN: Is the other railway not entitled, as it has done, to submit to us amendments to legislation that it thinks should come along?

MR. O'DONNELL: If it is from the point of view of rate-making. I am not discussing rate-making. I am not getting involved in that at all.

THE CHAIRMAN: Any legislation. We are talking of legislation. That is all we can do, recommend legislation.

MR. O'DONNELL: That is right.

THE CHAIRMAN: With regard to any part of the Railway Act.

MR. O'DONNELL: Yes. All I am endeavouring to do is to ask the Commission here not to allow its consideration of my problem to be affected by the consideration of a problem which is somebody else's at another time and place, and before another tribunal. That is all I am saying. Just treat me on the merits of my own case. If I have a case, then I ask that it be considered; and if I have a case for the adjustment of my capital structure, then deal with it on that basis.

COMMISSIONER ANGUS: Mr. O'Donnell, would you not say your probable future income is part of the merits of your case?

MR. O'DONNELL: I do not think so, necessarily, at all. I go back to the inception of the Canadian National Railway: three bankrupt corporations that could not be financed by anybody privately, that had to be taken over by the Government as such.

COMMISSIONER ANGUS: Suppose you had a commercial reorganization.

MR. O'DONNELL: Yes?

COMMISSIONER ANGUS: Of three bankrupt corporations which were amalgamated.

MR. O'DONNELL: Yes?

COMMISSIONER ANGUS: Would not the capital structure of the new organization be based on the probable income?

MR. O'DONNELL: It might. But to begin with, before the properties can be taken into the new company, they would be fixed at a proper valuation at that time. That is my point. At the time the C.N.R. was put together, the properties were taken in at the full value which was inflated and away out of line, and it has never been adjusted; and it had all that accumulation of old securities and the interest charges that went with it. That was never adjusted. It should have been adjusted.

COMMISSIONER ANGUS: I agree, but are they not two separate questions? One is, what ought your capital structure to have been twenty-five years ago and the other is what is the desirable capital structure today, taking into account all existing circumstances. You are going to speak of the second question, are you not?

MR. O'DONNELL: I am going to show that when it is adjusted, the position will be such and so; and that it is not out of line and that it is not unreasonable. I am saying that we have proven, we think, through the years of operation, that what we are asking for is a minimum; that we have had these deficits year in and year out charged against us, being virtually an excessive interest charge that we should never have had imposed on us; that if you take this out of the picture we have a fair chance of not having to report deficits. Some years we have a chance of reporting surpluses; maybe other years we will be reporting deficits, depending on what the business trend is. But on the assessment of the problem by the best

brains that the Canadian National Railway has available to it, its experts, its board of directors and the rest, it says that is what it thinks should result; and the Commission will weigh the evidence. It says if it gets the adjustment asked for it hopes to be able to get along without these deficits.

COMMISSIONER ANGUS: Are you not asking us to take the experience of those intervening years into account for the purpose of forecasting your future income? Is not that of significance? If those years happen to be lean years and for special reasons, then the forecast would be influenced by that fact?

MR. O'DONNELL: We have lean, we have fat; we have war and we have peace. We have the whole gamut of experience roughly in the twenty-seven years there, and the Commission will have to take all those facts into account. There is no question about that. As far as we are concerned, we have the evidence as to what we think the future will be in our company's operation and what it can do; and on those facts we put the problem before you and say that what we are asking to be done is reasonable, and that it should be done and also -- and I will get back to what precipitated this discussion -- I say at this stage it is something that is between our owners and ourselves, that the Commission has been set up to look into it; and then there is this. Let me put it this way. If we were a privately owned company --

THE CHAIRMAN: Pardon me a moment. Are you going to go on with this question of whether the C.P.R. comes into your case? I think you can put that aside for just now.

MR. O'DONNELL: All right. I just had one

observation to make on that, even if you give us the relief we are asking for, that does not settle the C.P.R.'s problem. The C.P.R.'s problem is altogether apart from that. The C.P.R. can only finance on its theory on the basis of selling stock at par. Whether we adjust our books or not is not going to help them.

THE CHAIRMAN: I do not think this is the time for that argument at all.

MR. O'DONNELL: All right.

THE CHAIRMAN: You had better go on with your own case.

MR. O'DONNELL: All right. I merely went in there, my lord, because I thought the question was directed to me. I simply say this, ~~and~~ I should like to put this on the record. I make this distinction between the organization of an enterprise from the capital structure point of view and approaching the matter from the rate-making point of view. I say that the situation is clearly pointed up by the quotation from the judgment of Mr. Justice Brandeis in that case of the Group of Institutional Investors et al v. Chicago, Milwaukee, St. Paul and Pacific Railroad, 318 U.S. Reports, 523, at 540, which will be found referred to at page 20417 of the record. There the learned judge, you will remember, said that "value" is a word of many meanings. He also said:

" . . . it gathers its meaning in a particular situation from the purpose for which a valuation is being made. Thus, the question in a valuation for rate-making is how much a utility will be allowed to earn. The basic question in a valuation for reorganization purposes is how much the enterprise in all probability can earn."

That is what we are putting before the Commission. We say in all probability we can earn so much, and that in the light of that we are asking that our capital charges be adjusted accordingly.

(Page 23815 follows)

In so far as Canadian National's case before this Commission is dealt with, it is only with this latter aspect that we are dealing, and we are not here with any request for a valuation for rate-making purposes; and I think the distinction was further made in the exchange of questions and answers between you, Mr. Chairman, and counsel for New Brunswick in volume 126 at pages 22766-67.

THE CHAIRMAN: What was that?

MR O'DONNELL: Well, my lord, you directed questions to Mr. Barry concerning the matter of yardstick -- I had better read it:

"THE CHAIRMAN: Just a moment, what you are saying there seems to be important. You say that it could be possible, after the C.N.R. capital structure is revised, to put it in a comparative position, (whatever that means) that it would be found that the C.N.R. cost of operation was less, in which event it would be unreasonable to accept a higher operative cost railway as the yard-stick. What would you do with the higher operative cost railway?

MR BARRY: They would just have to get more efficient and cut down their cost of operation. Assuming the railways to be in comparative position as to railway property investment and taking account of income tax differences to be paid by the C.P.R., that it may be found that the C.N.R.'s cost of operation will be less.

THE CHAIRMAN: The comparative position, you mean is comparative as to capital structure?

MR BARRY: Railway property investment, and making due allowance for income tax and taxation and things which the C.N.R. does not have to pay and the

C.P.R. does have to.

THE CHAIRMAN: Then if you have two railways then the cost of operation of one (of course they would not be exactly the same), one is higher than the other -- to take the needs of the lesser one?

MR BARRY: Yes, sir, if the country could not afford to maintain the higher one."

However, that, as I say -- and I will leave it at that -- has to deal with the situation when it gets to the rate-making body.

Now, for a proper understanding of the problem of the Canadian National concerning its financial difficulties, one must have in mind, I submit, the historical and statistical data which have been set forth in the main brief in some considerable detail. It is not my purpose to take the time of the Commission in reviewing the data at this point. The detailed story of the manner in which the Canadian National's excessive capital debt burden accrued will be found in the brief at pages 12 to 72. We take the situation as it is at the present time and demonstrate to the Commission the extent of the excessive capital debt burden of which the Canadian National complains today and for which it seeks adjustment and relief.

Now, the excessive debt burden of the system is, in our view, \$1,533 million.

THE CHAIRMAN: You are not overlooking, are you, the particular wording of this clause (c), that is, the advisability of establishing and maintaining the fixed charges of the Canadian National Railway on a basis comparable to other major railways in North America?

MR O'DONNELL: No, I do not think so, my lord. I have that in mind, and I will come to that later.

The excessive capital debt burden, I say, of the system is, according to our view, \$1,533 million. That is the fixed charges, and they, we say, are attributable to certain characteristics which are readily discernible. They to a large extent flow from the circumstances under which the system itself was created, and I wish to mention them briefly at this point, as I intend to discuss each one of them shortly.

The first one, and by far the most important portion of this excessive capital debt burden, is attributable to the fact that all the outstanding securities of the three privately-owned railways, to all intents and purposes insolvent at the time they were brought into the system, were imposed upon the system. These securities, consisting of interest-bearing obligations of \$804 million, and carrying with them fixed charges in excess of \$35 million per annum, should, as I said a few moments ago, have been entirely written off or at least reduced to a non-fixed interest or equity basis.

The second factor going to make up this burden is the physical condition of the railways themselves, which, run-down and semi-finished as they were, contributed likewise to the excessive burden, in that it was necessary for the system to spend substantial sums of money for improvements which did not add to the earning power of the system.

Thirdly, in addition, since the systems had previously been in active competition one with the other, and since they were to be operated as one, substantial expenditures were required to bring about co-ordination.

Fourthly, a considerable additional burden was imposed on the system by reason of moneys expended by it in connection with the operation of the Canadian Government

Railways as part of the system.

Fifthly, through the cost of acquisition and rehabilitation of a number of unremunerative lines which from time to time the Government in the national interest acquired and caused to be incorporated in the national system, the income account of the Canadian National has been very adversely affected, and as the years have gone along the burden has not been lessened.

Then recently, through the entrustment of the Newfoundland Railway and Steamship services and the Temiscouata Railway, the burdens have been increased.

Seventhly, large amounts of capital have, moreover, been expended on the development of branch lines, determined upon to foster the national interest by the issue of interest-bearing obligations, whereas the Canadian National contends a substantial portion of the cost should have been provided in the form of equity financing.

Now, the excessive burden resulting from these items which I have mentioned amounts to \$1,533, and it is that which we submit should be adjusted and which we submit should never have been saddled upon the railway in the beginning. It has borne these burdens for a long time, and, while many people have said that the burden is excessive through the years, no one has ever done anything about it, and it is that that we now ask relief for.

It will be remembered, my lord, that evidence was given as to the items constituting the total burden of \$1,533 million by Mr. Gordon.

I might just say at this point that in so far as we are concerned we regard the matters with which we are dealing as questions of fact and of opinion based on fact, and in the circumstances I propose, with the consent of the Commission, to read such parts of the evidence as I consider

pertinent. It is now some time since the evidence was put in, and that would serve to refresh our memories of it and also to have the various bits and pieces throughout the record assembled more or less in one place, which will permit of easy reference and which I hope may be of assistance to the Commission during its deliberations.

COMMISSIONER INNIS: You do not think any difference can be made between these items?

MR O'DONNELL: Which, Dr. Innis?

COMMISSIONER INNIS: Well, the interest-bearing obligations of \$804 million, perhaps one can concede that that has a special status. It seems to me that an item such as co-ordination costs is one on which you have expended money to improve the property, and it seems to me it is in a rather different category.

MR O'DONNELL: Well, as to that, I would like to put the evidence again before you in as fair shape as I can, and from then we will have to deal with it. Each one of them does stand on its own particular set of facts, and they are different items approached from a different point of view.

So that the Commission in following the items will have as little trouble as possible, I thought it might be helpful if we had a tabulation of the items made, and it might be of convenience if we had the transcript writer just put it into the transcript at this point.

(Tabulation follows on page 23820)

CANADIAN NATIONAL RAILWAYSDETAILS OF CAPITAL DEBT BURDEN OF \$1,533,000,000

| | | |
|---|--------------------|------------------------------|
| A. <u>Interest-bearing obligations assumed with acquisition of insolvent railways</u> | | \$ 804,000,000 |
| B. <u>Run-down and semi-finished condition of property</u> | | 100,000,000 |
| C. <u>Co-ordination Costs</u> | | |
| Co-ordination costs proper | \$ 40,000,000 | |
| Maintenance and operation costs | <u>250,000,000</u> | 290,000,000 |
| D. <u>Canadian Government Railways</u> | | |
| Additions and betterments | \$ 28,543,105 | |
| Rolling stock | <u>80,749,534</u> | |
| | \$109,292,639 | |
| | (Rounded off) | 110,000,000 |
| Pension Fund | <u>25,000,000</u> | 135,000,000 |
| E. <u>Effect of acquisition of unremunerative lines in national interest</u> | | |
| 1. <u>Cost of acquisition:</u> | | |
| Inverness Rly | 375,000 | |
| Kent Northern | 60,000 | |
| Gaspé Lines | 3,500,000 | |
| St. John & Quebec | 6,000,000 | |
| Quebec, Mtl. & Sn. | <u>5,920,361</u> | |
| | 15,855,361 | |
| Cost of rehabilitation: | <u>1,911,438</u> | |
| | \$ 17,766,799 | |
| | (Rounded off) | 18,000,000 |
| 2. <u>Increased operating expenses in connection with above lines</u> | | 12,000,000 |
| 3. <u>Newfoundland Railway and Steamship Services</u> | | 134,000,000 |
| 4. <u>Temiscouata Railway</u> | | <u>6,000,000</u> 170,000,000 |
| F. <u>Effect of Development Lines</u> | | <u>34,000,000</u> |
| TOTAL | | <u>\$ 1,533,000,000</u> |

MR O'DONNELL: I have assembled on this tabulation the various details of capital debt burden going to make up the \$1,533 million, and it is to assist the Commission and to permit more readily of following the evidence that I intend to refer to, that I have had this done.

The first item there, item A, is "Interest-bearing obligations assumed with acquisition of insolvent railways'."

THE CHAIRMAN: Does that include all the obligations in the hands of the public?

MR O'DONNELL: Yes; those are the obligations which were assumed at the time the insolvent railways were taken over.

Now, as to the interest-bearing obligations, Mr. Gordon told the Commission that the Canadian Northern and the Grand Trunk Railway Systems were acquired by the Government in the national interest as going concerns, without having been put through bankruptcy proceedings, and that as a result the Canadian National at its inception was burdened with interest-bearing debt to the extent of \$804 million. In the circumstances which prevailed when these systems were acquired, the fact that they were without the hope of attracting any private capital whatsoever, that their earning capacity was without promise, and hundreds of millions would have to be invested to take care of deferred maintenance, necessary improvements and co-ordination costs, Mr. Gordon stated that it seemed reasonable that the entire amount of these interest-bearing obligations which I mentioned a moment ago should be converted into equity capital.

The testimony of Mr. Gordon was fully supported, I submit, by detailed information given concerning this matter by Mr. Cooper and Mr. Fairweather. Mr. Cooper's

testimony on this point will be found in volume 98 at pages 18469 and 18476, and again in volume 99 between pages 18525 and 18535. He produced Exhibits 218 and 219 substantiating his corroboration of Mr. Gordon's statement that the \$804,503,144 of interest-bearing debt had been imposed upon the Canadian National at its inception in 1923. Mr. Cooper identified the obligations which were comprised in the said amount of interest-bearing debt, indicating the extent to which there were obligations of the Grand Trunk Railway Company of Canada, the Canadian Northern Railway or the Grand Trunk Pacific Railway (p. 18472), pointing out that in some instances the said obligations had been on a contingent basis, and that following the acquisition and amalgamation they were through the action of the Government converted into obligatory charges.

When under cross-examination by Mr. MacPherson, Mr. Cooper, speaking of this \$804 million of obligatory interest-bearing charges, said (vol. 101, pp. 18850-1):

"Based on the past earning record of those companies" --

Grand Trunk and Canadian Northern Systems and the Grand Trunk Pacific --

"I think that substantially all of it should have been written off."

And again:

"When I said written off, I perhaps should have been a little more precise and said that it should have been converted into equity capital instead of being continued as fixed charge capital."

Further:

"I would say the debt would have been changed into equity capital."

Numerous other exhibits, the Commission will remember, were produced by Mr. Cooper during his testimony -- for instance, the Lovibond judgment, indicating the bankrupt condition and the financial difficulties of the companies -- and I will not detain the Commission longer concerning the evidence on this point. I submit that Mr. Cooper's testimony is beyond dispute, and, incidentally, I point out that it was not questioned.

Mr. Fairweather, who is very familiar with the circumstances which prevailed at the time of the acquisition by the Government of Canada of the Canadian Northern and the Grand Trunk Railway Systems, in volume 103 at page 19107, said in part:

" . . . I was one of those who had the responsibility of preparing the case for the Government on the acquisition of the Grand Trunk, and through the Grand Trunk I had knowledge of the Grand Trunk Pacific, and I was naturally interested in the Canadian Northern as being a part of the general picture at the time.

No one who had access to the facts could come to any other conclusion except that these railways were in a hopeless condition. Their credit was exhausted, they had only been kept in operation by means of Government loans, and the general condition of their property was run down. The business outlook was none too good. They had large capital needs, their earnings were insufficient to carry the burden of their existing debt, so that it was hopeless of them to try to finance additions and betterments which were essential to protect their competitive position. They were at the end of their tether, and they were in a state of virtual bankruptcy."

In supporting the foregoing I would like to refer

the Commission to the statement of the Hon. Mr. C. D. Howe, then Minister of Transport, when he appeared before the Standing Committee on Railways and Shipping owned and operated by the Government, on February 18, 1937. Mr. Howe said in part:

(Page 23824 follows)

"It is relevant at this time to make reference to the fact that the so-called 'publicly owned' portion of the National System was constituted in the first instance only by the Canadian Government Railways. The corporate portion of the present National System represented by the old Grand Trunk, the Grand Trunk Pacific and the Canadian Northern became 'publicly owned' when as private corporations they had reached the stage of financial embarrassment, if not complete bankruptcy. In view of the fact that these corporations did not pass through bankruptcy proceedings the present National System accounts reflect the accumulated errors of the past without the advantages that would have accrued to the National System as now constituted had the privately owned roads been subjected to the usual processes of capital adjustments arising out of bankruptcy proceedings. The Canadian National System was born in insolvency. This fact, I think, calls for consideration by those unfavourable to the capital adjustment because of the fear that the record of the relative merits of so-called 'public ownership' and 'private' railway operation would be disturbed if the C.N.R. balance sheet were adjusted to a basis of present-day realities."

THE CHAIRMAN: When was that statement made?

MR. O'DONNELL: That is in 1937. Now, it is

interesting to note, as I was saying yesterday - -

THE CHAIRMAN: Pardon me, that was a statement made in the House of Commons?

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: When?

MR. O'DONNELL: In 1937, on 18th February, in the debate on the Capital Revision Bill at that time. I said yesterday that it was interesting to note that while the majority of the Drayton-Acworth Commission had said in recommendation 23 (which I read before but I would just like at this point to have it on the record again):-

"We do not recommend that the Grand Trunk, Grand Trunk Pacific and Canadian Northern be allowed to go into the hands of a receiver."

They made this other recommendation , No. 28:-

"We recommend that the Government assume responsibility to the Dominion Railway Company for the interest on the existing securities of the transferred companies."

They obviously never intended, in my submission, that the new company should have the accumulated debts of the past with their heavy interest charges; and I say that even as of today recommendation 28 still remains to be implemented in the way that it was intended by these Commissioners.

It should be pointed out that the statement that I have just read as made by Mr. Howe was made during a brief outline of the provisions of Bill 12 which ultimately became the Capital Revision Act of 1937. The adjustments provided by that Bill, Mr. Howe said:-

"Confined itself to the relationship between the Government and the Railway and does not deal, in any way with the funded debt of the Railway in the hands of the public."

In connection with this matter, the Commission will remember that Mr. Cooper in Vol. 99 at pp. 18556-7, testified and made it clear that the matter of the adjustment at that time did not go far enough. The adjustment at that time, the Commission will remember, related only to a write-down of capital stocks and the old debentures.

THE CHAIRMAN: Far enough to do what?

MR. O'DONNELL: Pardon?

THE CHAIRMAN: Mr. Cooper said that the revision did not go far enough, and I want to know, far enough to do what?

MR. O'DONNELL: It didn't deal with the problem that we are placing before the Commission at this time, that is what it means. It dealt with the deficits which had been capitalized and interest on those deficits which should not have been put into the amounts which were taken down, and also there was a write-down of capital stock by current reductions of the property accounts at that time. But the accounts eliminated any connection with losses having to do only with sums lost in operation and accruals of interest, nothing to do with what I am talking about. I am talking about the problem of excessive capital debt, the problem as originally constituted through the taking into the company of the \$804 million which had nothing to do with that particularly.

This subject, that is, the debts of the

former bankrupt companies is dealt with in the report of the Senate Committee of May 11, 1939, at page 490 when the following appears:-

"The submissions to the Committee have been of great value and interest to the members and have served to enlighten the country at large upon this very important question. As a result of the inquiry it is possible that the Canadian people have acquired another view, possibly a totally different view, as to what our national railway property stands for in the life of the Canadian people. To many it has no doubt seemed that our national railways have been, as it were, a drag on Canadian progress because of the deficits. To many Canadians it will doubtless be news that the Canadian National Railways have no operating loss and that the deficits, about which so much has been heard and which admittedly have such a serious effect upon our national finances, pertain entirely to interest charges due public investors and relate for the most part to former privately-owned lines which the Government took over and continued in operation in the national interest. It is important also to bear in mind that the interest referred to is guaranteed by the Government of Canada and is a continuing obligation regardless of what disposition be made of the National lines."

THE CHAIRMAN: Did they make any recommendation?

MR. O'DONNELL: Not in that connection at that time.

THE CHAIRMAN: In any connection?

MR. O'DONNELL: No, not with respect to this problem that I am referring to at all, my lord. They reviewed the situation concerning agreed charges and a number of other things. The Committee was set up to inquire into the best means of relieving the country from the extremely serious railway situation.

THE CHAIRMAN: What is the date of that?

MR. O'DONNELL: That is May 11, 1939.

COMMISSIONER INNIS: That was to relieve the country, not the railways?

MR. O'DONNELL: That is right, to relieve the country, not the railways; and the heading on the appointment of the Committee reads:-

"To inquire into and report upon the best means of relieving the country from its extremely serious railway situation and the financial burden consequent thereto."

but not to relieve the railways, as Dr. Innis has said. According to that Committee the Government in the final analysis has guaranteed the debts and they are a continuing obligation regardless of what disposition has been made of the National lines. So that we simply say they should not be in our bookkeeping at all; and that to clarify our bookkeeping and allow us to report a truer picture of the result of operations, these things should be taken out and be put where they should have been put in the original instance.

THE CHAIRMAN: When you say the Government has guaranteed the debts, what debts do you mean?

MR. O'DONNELL: This \$804 million and anything that is - -

THE CHAIRMAN: How much of that is left really as a debt owing by the Government, \$580 million, isn't it?

MR. O'DONNELL: That is in the hands of the public, yes, \$584 million.

THE CHAIRMAN: The rest the Government owes itself ?

MR. O'DONNELL: Yes, the Government has \$760 million odd of these bonds in its hands, but the railway is asked to pay the interest on the bonds, and when the railway does not earn the interest it gets a vote solemnly from the Government to take care of these things. So that really, as your lordship says, the Government is the owner of the bonds, the Government is entitled to the interest, and the Government has to find the interest. And, as the Senate Committee said, it doesn't make a bit of difference, it is a continuing obligation regardless of what disposition be made of the National lines.

THE CHAIRMAN: Your case looks simple when put that way.

MR. O'DONNELL: It is simple.

THE CHAIRMAN: Yes, but how do you construe this reference to us? Let me make it to you. We are asked to advise whether or not the fixed charges of your company should be established and maintained on a basis comparable to other major railways in North America.

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: Have you taken the trouble to investigate the fixed charges of other major railways in North America?

MR. O'DONNELL: Yes, I think, my lord, with respect, that we have done that. In the main Brief we did give quite some detail on that.

THE CHAIRMAN: Do you think that what you are asking us to do is no more than to put you on a basis which would cause you to become reasonably comparable?

MR. O'DONNELL: We think so, yes.

THE CHAIRMAN: And you give in your Brief, you name the companies with which you wish to be made comparable?

MR. O'DONNELL: We point to a number of railways.

THE CHAIRMAN: Including Canadian Pacific?

MR. O'DONNELL: Including Canadian Pacific. We point to a number of specific American Railroads. We say, however, that possibly the best way to look at the American railroads is to take them as a class, because there are those with very high charges and those with very low charges. We say, take them as a class or pick out five of the biggest railways ~~that~~ that are most comparable so far as we can find. Compare us even with the Canadian Pacific. Look at us in any way you please: ^{in any aspect at all} we are out of line, /that is the position .

THE CHAIRMAN: Are you asking merely to be put in line with these companies?

MR. O'DONNELL: That is what we say, yes, and we also say this, that apart from that aspect of it there are these lines (and this problem is peculiar to our road) operating in the national interest which makes us have another type of headache, and that is something as well to look at. But we say insofar as fixed charges are concerned, if this relief be granted to us as requested, that we are comparable insofar as comparability can be achieved, reasonably comparable.

We say that it will have the result of letting us live the strong, dynamic, healthy, vigorous life that our friends have spoken of on several occasions, and to which we think we are entitled. That was the original view when this company was set up.

COMMISSIONER ANGUS: Mr. O'Donnell, wouldn't you want this relief whether it were comparable or not?

MR. O'DONNELL: Absolutely.

COMMISSIONER ANGUS: I mean, is comparability the essence of the matter, or is it really that the individual and unique situation makes it desirable?

MR. O'DONNELL: I think we can make out a case either way. We can say on the basis of comparability we are definitely out of line, and on the basis of our capital structure requirements we are entitled to an adjustment by reason of those facts we are talking of.

THE CHAIRMAN: If we were to grant you everything for which you ask, that wouldn't necessarily make you incomparable, would it?

MR. O'DONNELL: I don't think so, except insofar as service is concerned, and we will take a stab at that.

COMMISSIONER INNIS: But you always have been in that matter?

MR. O'DONNELL: Always have been.

COMMISSIONER ANGUS: The Commission is asked to say whether comparability is desirable.

MR. O'DONNELL: That is right.

COMMISSIONER ANGUS: Is it really comparing like with like or is it comparing something that is unique on this continent with others which are basically different?

MR. O'DONNELL: There are some aspects of our operations that are unique, that is true. There are other aspects which are the same as those of all railroads operating. I think there one must read that direction in the Order-in-Council in a broad and reasonable way, and that that is an indication of one aspect that your Commission might consider in determining what revision there should be of the capital structure.

COMMISSIONER ANGUS: Do you take it that way, or do you take it that the question in the Order-in-Council is really directed to us to say that comparability is desirable?

MR. O'DONNELL: No, I don't take it that way at all. I take it that you are asked to review this problem. It has been a contentious one through the years; it has been one which, as I can cite and will cite, any number of people say it should have been disposed of a long time ago, Government officials and other bodies. I am simply saying that the Government has said: "Let us settle this problem, let us see what there is in it. We may have a prejudiced point of view in some respects. At any rate, we will refer this to a tribunal to look at it so that we get the broadest approach to it. We say, review the capital structure of the Canadian National Railways on the advisability or otherwise of Canadian National being on a basis comparable to other major railways in North America."

THE CHAIRMAN: Those are very important words, you know.

MR. O'DONNELL: I know that. I say we have a case on that aspect of it, and we hope that when you have reviewed it you will so recommend in accordance with.

our proposal.

COMMISSIONER INNIS: As to the problem of comparability, have you every tried to imagine what would have happened if it had gone through receivership, as to what the difference in the capital structure would have been? All American railroads, I suppose, without exception have gone through the wringers once or twice or several times.

MR. O'DONNELL: Yes.

COMMISSIONER INNIS: And one would get a comparable position, one would at least try to imagine what might have happened if they had gone through.

MR. O'DONNELL: What we say is this, we say that at this time, 23 years after the event, it is very difficult to know exactly what the result at that time would have been. So we say that all we can do is to bring the best business assessment, business judgment in the matter to bear on it and say what the position was then and, endeavouring to rectify it today, what should have been done then and what is reasonable today. That is the approach we take to the problem. We cannot approach it with mathematical exactitude as to the amount at which Canadian Northern property should have been taken in or the Grand Trunk Pacific or anything else. We say: Here we are faced with that over-all problem today. If as a private company we had purchased them from the receiver in 1923, we would not have paid anything like the price they are put on our books.

COMMISSIONER INNIS: I was wondering just what you would have paid?

MR. O'DONNELL: That is something which, as I say, I cannot with mathematical exactitude determine but all we do say is this - the problem being what is was, we say the best compromise - and that is all we can do with it - having assessed the price we cannot assess it at what we think is reasonable to all concerned and that is the way we approach the thing.

COMMISSIONER INNIS: I was wondering if you were not asking too much with it all?

MR. O'DONNELL: We are not asking that it be all. I am saying it should have been all. We have a claim we say--

THE CHAIRMAN: Where is the page where you set out your comparison with other railways?

MR. O'DONNELL: I intend to come to that a little later, Mr. Chairman. You say, Dr. Innis, "Aren't you asking too much in asking for it all?" I say we are not asking for it all today.

THE CHAIRMAN: All of what?

MR. O'DONNELL: The abolition of it all. We say the \$804 million should never have been imposed on us and we have a claim for one billion five hundred and thirty-three million on the tabulation we have put before you this morning. We say that is what the claim is but when we come to the proposal as made by Mr. Gordon that we will compromise and settle for \$1,060 million. That is the situation and all these factors come into play, they are assessed and they are valued and the management and the Board of Directors say "Well, that claim being what it is, if relief to the extent of \$1,060 million is allowed, we will consider that as fair under the circumstances". That is the best judgment we can make of it and to try and cast one's view back to 1923 is very difficult but we agree on that right away and we

say we are trying to come forward with something which in all the circumstances is fair to all parties.

COMMISSIONER INNIS: Supposing you were buying it today, what would you pay for the railroad?

Mr. O'DONNELL: Buying it today, I do not know. That is something else.

COMMISSIONER INNIS: You have set the amount as the final price you are putting on it?

MR. O'DONNELL: I am not in a position to sell, if that is what you are asking, but we are saying simply this - this claim has been a long outstanding one. We have never acquiesced in its having been put on us and we think it should be adjusted and we think if it is adjusted it is not going to hurt anybody and it is going to help us. It does not affect our owner and it is a matter between our owners and ourselves.

COMMISSIONER ANGUS: On the question of comparability, Mr. O'Donnell, is this right - that if comparability would not have been illegal then it is advisable and if it will be it will not be advisable?

MR. O'DONNELL: Unless you want me to embark on that now I have lined it up in another way and I would rather like to put before you what we say the claim is and then I propose to show what the proposal means to the results that would be achieved in our view and to discuss comparability at that time. If I can be allowed to do that - I know we will have to answer that question but for the purpose of the record I would like first to cover the items on the tabulation and then try to dispose of whatever questions are put to me with respect to that other problem which I know is one we have to discuss.

I was just ending my remarks, I think on the first item on that tabulation, that is, item A, and I submit -

oh, there was one other citation, I think, that I might have read from the report of the Senate Committee on the 11th of May, 1939. The Committee further said:

"The Committee was impressed with the large measure of public service rendered by the Canadian National Railways in the interests of pioneering and development, the cost of which is included in the deficits referred to. These services are of great value in the economic development of the country, but cannot be operated at a profit from the purely railway standpoint. It is felt that it would be disastrous policy to attempt to eliminate railway deficits by the withdrawal of essential railway facilities."

We, according to the Senate Committee at least are acknowledged to be operating lines in the public interest which cannot be operated at a profit and those are some of the lines which we will refer to in this tabulation.

In leaving that item A, I submit very respectfully that the incontrovertible evidence is that the \$804 million of interest bearing debt was wrongly imposed on the Canadian National at its inception and I point out that that has not before this Commission been questioned by any evidence that was led. It has been established and has not been controverted.

Now, as to the second item B, the run down and semi-finished condition of property for which the Canadian National feels it has a claim that it assesses at \$100 million, this second item of excessive capital burden concerning which Mr. Gordon testified in Vol. 98 p. 18380 is an item of \$100 million spent for "necessary improvements to the property which did not add to the earning power of the system",

It will be remembered that Mr. Gordon testified --

THE CHAIRMAN: Which have not you say?

MR. O'DONNELL: Which have not added to the earning power of the System - "necessary improvements to the property which did not add to the earning power of the System". The evidence as to that is this. It will be remembered that Mr. Gordon testified that the privately-owned properties when taken over were badly run down, and in the case of the Canadian Northern cannot be said to have been property completed and equipped. While large amounts were expended on rehabilitation and construction prior to 1923, a great deal still remained to be done to take care of the situation on the lines of the Canadian Northern and the Grand Trunk Railway Systems at the time of consolidation.

COMMISSIONER INNIS: Any division as between them.

MR. O'DONNELL: Yes, I think I have.

COMMISSIONER INNIS: Between the Canadian Northern and the Grand Trunk?

MR. O'DONNELL: Yes, we have that evidence, I think.

Based upon the authority of statements in the report of the Drayton-Acworth Commission and upon the Grand Trunk Arbitration Award (Vol. 98, p. 18478), Mr. Cooper stated that he felt the figure of \$100 millions, which represented necessary improvements to the property, which did not add to the earning power of the System is "somewhat of an understatement".

The detailed description of the vast sums which had to be spent in respect of the Grand Trunk System were read unto the record by Mr. Cooper at pp.18489-90. At page 18494 Mr. Cooper made reference to the run down condition of the Canadian Northern Railway, the Grand Trunk Pacific and said that "something should be added with respect to the Canadian Government Railways."

The Following question and answer appearing at page 18496 strikingly summarizes Mr. Cooper's view of this item and entirely corroborates Mr. Gordon's estimates:

It is exactly the estimate of the Company prepared by its officers and personnel who have been with us for many years and as every president of every company does he gets the reports from the experts who have detailed information."

I read that question and answer:

"Mr. Cooper, from what you have just told the Commission, you are satisfied that the \$100 million on page 8 in Mr. Gordon's statement is reasonable as representing the amount which was necessarily expended, or, rather, which was expended for necessary improvements to the property which did not add to the earning power of the system?

A. Yes. The evidence is, the Grand Trunk needed over \$50 million; the Canadian Northern needed \$70 million: We do not know the requirements of the Grand Trunk Pacific and the Canadian Government Railways, but undoubtedly it would be a sizeable figure. Sir Joseph Flavelle gave the figure as something in between \$125 million and \$175 million for the National System. Therefore it seems to me that \$100 million is reasonable and can be accepted."

That is the evidence of Mr. Cooper. Now, Mr. Fairweather's testimony concerning this same subject, that is, the item of \$100 million as an estimate of the amount of necessary improvements to the property which did not add to the earning power of the System - is in Vol. 103 beginning at page 19114 and continuing to page 19117. Mr. Fairweather described in some detail the improvements which had to be made and the extent of their cost. He said in part at the bottom of p. 19115:

".....these properties, when they were taken over, were in this condition: either the capital necessary to support the earning power was not there, or the prior owners, in an attempt to maintain solvency, had diminished the capital assets in their attempt to maintain solvency.

So, as a result, the Government, when it acquired the property, was in the position of having to replace or make good this deficiency of capital, and I submit that in that sense this \$100 million did not add to the earning power."

And then, at the top of page 19117, Mr. Fairweather said and I quote:

"Now, if you add those items up, you get \$120 million and I think that would indicate the estimate of \$100 million is a reasonable one."

I did not read all the other detail that went in support of it.

Now, that is the evidence of Mr. Cooper and Mr. Fairweather and the statement of Mr. Gordon concerning that second item on the tabulation, item (b).

COMMISSIONER INNIS: It is awfully difficult to think of \$120 million being spent without adding to the earning power.

MR. O'DONNELL: That may be, Dr. Innis, but the only evidence you have before you is the evidence of the people who live with the problem, know the problem and who gave their testimony here as to what the total was. We are dealing in enormous figures. These railways, every time one looks at a statement it is in six or eight or nine figures and there is no question about it that those are large figures and Mr. Fairweather says, and you will remember he has been with this railroad for nearly forty years - with this railroad and predecessor companies and he says: "That ^{the} is/valuation" and Mr. Cooper gives the figure in his evidence and says: "There it is" and they have said "These improvements do not add to the earning power of the System". They could have run the railroad humpty-dumpty without doing it but it did not add to the earning power of the road.

COMMISSIONER INNIS: That would be very difficult to defend?

MR. O'DONNELL: That may be, Dr. Innis, but the only evidence you have is that. It is a blunt statement and nobody cross-examined Mr. Cooper or Mr. Fairweather about it.

COMMISSIONER ANGUS: Answering Dr. Innis's question a few minutes ago as to what the railway was worth would seem to be that it was \$100 million less than nothing.

MR. O'DONNELL: That all depends on whether you are the buyer or seller but as to this particular item, the evidence is there and there is no other evidence.

--Recess.

(Page 23844 follows).

---After Recess:

THE CHAIRMAN: Very well, Mr. O'Donnell.

MR. O'DONNELL: May it please the Commission, I now come to the third item on that tabulation that I gave the Commission earlier this morning, the item C, Co-ordination Costs. You will note that that divides into two branches. Co-ordination Costs provides an item of \$40 million and maintenance and operation cost, \$250 million, and the total of that particular item, Co-ordination Costs, under that heading is \$290 million, we contend in excess of the capital/^{debt}burden. This item was mentioned by Mr. Gordon.

THE CHAIRMAN: Pardon me a moment. As to the word "co-ordination", it is co-ordination of what?

MR. O'DONNELL: That is merely a description I have put on the item here for the purpose of following it. I think that as your lordship hears the argument, it will be quite clear.

Mr. Gordon, in Volume 98, at page 18381 to 18382 states:

"The Canadian National management following consolidation was faced with the co-ordination of the previously competing systems."

THE CHAIRMAN: Oh, yes, I understnad.

MR. O'DONNELL: I continue to quote:

"Co-ordination, it is estimated, has required the expenditure of \$40,000,000 for main-line connections, belt lines and terminal re-arrangements, notwithstanding which, the property falls considerably short of having a proper location of main lines in relation to branch lines and of terminals in relation to its traffic pattern which would have been

secured had the property been designed and constructed as an entity.

"The System has more mileage than is functionally necessary to meet its requirements. The excess mileage has been reduced to some extent by abandonment of duplicating facilities where this could be done without injury to the national economy. This applies to those instances where the duplicating facilities were located so closely together that one of the lines would serve all needs of the community. Generally, however, this is not the case and the lines which are functionally duplicate as main lines also serve the local needs of the communities through which they run. The practice in such cases was to choose the better line as the main line and to continue the other in service as a secondary line."

THE CHAIRMAN: That all cost \$40 million. Is that it?

MR. O'DONNELL: Yes. That is the item that ^{the} is covered by/\$40 million. Then I go on:

"There are 3820 miles of line on the Canadian National which were originally constructed as main line and which in the process of co-ordination have been reduced to secondary lines.

"The maintenance and operation of these lines is a burden upon the System, even when allowance is made for their use as secondary and branch lines."

That is the second branch of this item.

"The maintenance and operation of these lines is a burden upon the System, even when allowance is made for their use as secondary and branch lines. This burden on revenues should be taken into account in considering the capital structure of the System.

"It is estimated that the burden constitutes an operating disability in excess of \$8,000,000 annually or an equivalent capital disability of \$250,000,000, which in a sense is, and for convenience might be described as negative capital. This amount, together with the money expended upon co-ordination projects, totals \$290,000,000."

The attention of Mr. Cooper was directed to this item; and in Volume 98, at page 18497 this question and answer appear:

"Q. What can you say to the figure of \$40 million which is there mentioned, Mr. Cooper?

"A. That is a figure that Mr. Fairweather will deal with. I know that the railway did spend considerable amounts for projects of this nature. Obviously when four railway systems are joined together connections have to be made, joint terminals rearranged, motive power and car repair facilities made suitable for operation. May I direct the attention of the Commission to what is said regarding this subject at pages 20 and 21 of the main brief. From what is said there, there seems little doubt the figure of \$40 million is a conservative estimate."

The extract from the main brief, Exhibit 214, to

which Mr. Cooper directed the attention of the Commission, appears on the same page -- that is, page 18497 -- and reads as follows:

"To co-ordinate the four separate and in some respects competing railways into one unified system necessitated large expenditures, both on capital and revenue account. The work comprised the building of connecting lines and cut-offs to permit a more economical routing of traffic, and joint use of terminals, stations, offices and other facilities. Grade reductions were undertaken, terminals were enlarged and modernized, some sections of the railway were double-tracked, heavier rail laid, bridges, trestles and culverts strengthened or replaced with permanent work. Much ballasting had to be undertaken and a start was made on the use of treated ties. Additional rolling stock was acquired and in addition many units were rebuilt, reinforced and improved. Much of the work had been done during the period of Government control but much still remained to be done. On a railway with 21,850 road or first main track miles in operation, employing well over 100,000 people, owning thousands of locomotives, freight cars and passenger cars, it is understandable that large sums of money were involved.

"The Chairman: Now, that explains the \$40 million.

"Mr. O'Donnell: Yes, my lord.

THE CHAIRMAN: That was twice that I asked the same question.

MR. O'DONNELL: You may have asked the same

question; that is right.

COMMISSIONER INNIS: How much of that was for the Long Lac cut-off?

MR. O'DONNELL: I think some of it is.

COMMISSIONER INNIS: You do not know how much?

MR. O'DONNELL: No, I do not know how much.

COMMISSIONER INNIS: It will come out later.

MR. O'DONNELL: Yes. We have some further testimony here.

THE CHAIRMAN: You say you have had to spend \$40 million on this and now you have to run it?

MR. O'DONNELL: That is right.

THE CHAIRMAN: At a disability; that is, you pay out \$8 million a year. What do you want us to do about that?

MR. O'DONNELL: We suggest that your consideration should be given to that, and that a recommendation should ensue that that part of our problem, treated as part of the whole problem, should be settled on the basis we propose, whereby this \$1,533 million of capital debt burden which we say is excessive and that we should not have to pay, should be settled on the basis of the proposal that we have put forward; that compromise basis.

THE CHAIRMAN: What would become of the \$290 million figure you have here?

MR. O'DONNELL: That would be merged in the settlement. It is only a component part of the total of \$1,535 million which we propose to settle, on a compromise basis, for \$1,060 million.

In Volume 103, beginning at page 19117, Mr. Fairweather discusses the figure of \$40 million regarding co-ordination costs. He listed a number of miscellaneous items concerning which he said at page 19120:

"A. They all add up to \$40,000,000. Actually, I added them up and it made \$40,300,000. But I rounded it out to \$40,000,000."

As the Commission will remember, the matter of Co-ordination Costs was commented upon by the Duff Commission at page 13, paragraphs 29 to 31, and I may say that this is under the heading "Administration, Canadian National Railways, 1923-1931".

"29. As will be seen from the preceding outline of their development, the Canadian National and the Canadian Pacific railway systems were established under wholly different conditions. In comparing the results of the operations of the two companies this important difference should at all times be kept in mind.

"30. The Canadian Pacific Company has been developed as a single, unified system. The mileage added has been complementary to existing mileage.

"31. The Canadian National Railway, on the other hand, represents for the most part the consolidation of lines that were constructed by private companies and which were, in many respects, competitive systems. Then there came to be included within the consolidated system extensive track mileages which are duplications. This applies not only to the main line, but to branch lines. In short, while the mileage of the Canadian Pacific has been complementary, the Canadian National system, developed under different conditions, has been handicapped by

any mileage of non-complementary lines, and the elimination of these duplications has yet to be accomplished."

Mr. Fairweather gave extensive testimony, I submit, corroborating Mr. Gordon's statement:

" . . . the property falls considerably short of having a proper location of main lines in relation to branch lines and of terminals in relation to its traffic pattern which would have been secured had the property been designed and constructed as an entity."

That quotation is to be found in Volume 98, page 18381.

Then in Volume 103, at page 19120, he says in part:

"So this co-ordination action is not complete.

"It has been ^{as} handled by the management as prudently and/carefully as they knew how, with the object of minimizing costs and of maximizing the benefits. But it is a program which will have to continue."

The situation was very graphically, I submit, put before the Commission by Mr. Fairweather when he produced and explained Exhibit 258, -- which was filed at page 19121, Volume 103 -- a map showing the main lines of the Canadian National, the duplicate main lines which were built by predecessor companies, but which under Canadian National management have been relegated to secondary status; and branch lines.

Mr. Fairweather proceeded to explain the operating disabilities resulting from the effects of the system inherent in the attempt to co-ordinate the previously competing systems. He commented at page 19127:

". . .this lack of unity, sir, never shakes itself down; it is a continuing disability."

Mr. Fairweather commented upon the mileage in excess of that functionally necessary to meet the system's requirements, which is clearly demonstrated by a further map produced by Mr. Fairweather as Exhibit 259, illustrating duplication of Canadian National main line mileage.

I think the Commission will remember those two long maps with the vari-coloured lines on them indicating and explaining the testimony which Mr. Fairweather gave in connection with them.

At pages 19133 to 19135 Mr. Fairweather explains in detail and conclusively, in my submission, the operating disabilities and adverse financial effects resulting from the excessive duplicate mileage in its various aspects. At pages 19134 and 19135 he said that these items totalled:

". . . \$10,360,000 according to my figuring.

And then, to be sure I was on the safe side, I took approximately 20% off of that to get my figure of \$8 million. In my judgment, the \$8 million is a very conservative figure."

And then on the next page he said:

"I certainly feel that \$8 million is an understatement."

The said annual operating disabilities of \$8 million, or an equivalent negative capital disability of \$250 million, when added to the \$40 million results in a total of \$290 million referred to by Mr. Gordon under the heading "Co-ordination Costs," in Volume 98, page 18381. That is the total figure of \$290 million on the tabulation under the heading "C".

I come then to the next item of the tabulation, Item "D", the excessive capital debt burden resulting from

the operation by the Canadian National Railways of the Canadian Government Railways.

COMMISSIONER INNIS: You make no estimate as to what the total continuing burden of the Canadian National is, say, as compared with a line such as the Canadian Pacific which is an integrated line. You have given the different items and you have given the total for the Canadian National.

No.
MR. O'DONNELL: We say that these particular items are items that are different from their items. They have not anything relating to this. It is a special problem of ours.

COMMISSIONER INNIS: What is the total burden that is involved?

MR. O'DONNELL: The total burden on that particular item, we submit, is \$290 million. The Co-ordination Costs themselves are \$40 million. ^{there are} Then the maintenance and operation costs, where the cost of co-ordination ^{are} by reason of the fact that we have not got the terminal facilities where they should be, and that the line is not as efficiently set up as it would have been had it been originally built as an entity; that we have this continuing disability year in and year out which we capitalize at the figure of \$250 million.

COMMISSIONER INNIS: That is what it really comes down to, \$250 million. What I am thinking of is what is the expense which is involved in the items which you cannot co-ordinate?

MR. O'DONNELL: I think that possibly is part of the maintenance and operation costs. We cannot estimate those any closer than we have got it here. We say we were forced to expend in capital expenditures to co-ordinate, what we call co-ordination costs, \$40 million. Then we say that even when we have made that expenditure, we

are faced with the disability of operating and maintaining these in excess of what it should have been if the lines had been built as an entity and in accordance with the language of the Duff Report. The Duff Report makes it clear, and the C.P.R.'s brief points out, that the C.P.R. was built as an integrated entity, and built up of complementary lines. We took over three bankrupt railroads. We had to join them together, co-ordinate them and operate them as one entity in accordance with the Drayton-Acworth Commission recommendation. To do that we had to expend \$40 million originally, and when we have got that expenditure made, then we suffer a continuing disability year in and year out because we have not got the terminal where it should be or something else.

COMMISSIONER INNIS: That is the disability you have told us about?

MR. O'DONNELL: Yes.

THE CHAIRMAN: \$8 million a year.

MR. O'DONNELL: Yes; and capitalized at 3%, that is, roughly, the \$250 million item.

The next item on the tabulation is Canadian Government Railways. I wish to direct the attention of the Commissioners to this matter. The total of this item is \$135 million, and it falls conveniently into three items: Additions and betterments, \$28,543,105, and items spent for rolling stock of \$80,749,534, rounded off at a total of \$110 million; and then the pension fund for \$25 million more. References to the evidence I will give will, I think, make these items clear.

Under this heading the pertinent part of Mr. Gordon's statement -- and it is to be found in Volume 98, pages 18382-83 -- reads as follows:

"The Canadian Government Railways constitute a considerable portion of the Canadian

National System. Prior to the formation of the Canadian National System and the entrustment to it of the Canadian Government Railways, capital for these lines was provided by the Government free of interest. During the years of administration by Canadian National a change was made and the System has since been burdened with interest-bearing capital for additions and betterments and for rolling stock, which at the present time has accumulated to some \$110,000,000.

"There is a pension fund, closed to new members in 1929, which is applicable to the Canadian Government Railways. This fund is more expensive to support than the general pension fund of the Canadian National to the extent of an equivalent capital amount of \$25,000,000. Taken in conjunction with the \$110,000,000 above mentioned, this makes a total of \$135,000,000.

"While attention is directed to this situation --" I think that is as far as I need to go with that quotation.

With reference to these items of \$110,000,000 of interest-bearing capital for additions and betterments and for rolling stock, and an equivalent amount of \$25,000,000 to support the more expensive pension fund applicable to the employees of the Canadian Government Railways, Mr. Cooper gave testimony which will be found in Volume 98, commencing at page 18500 and continuing to page 18506.

Mr. Cooper produced Exhibit 221 which shows the capital expenditure made by the Canadian National on the Canadian Government Railways since entrustment.

I think the Commission may remember that exhibit which shows the details of the matter set out there very

completely. Mr. Cooper said at page 18501:

"A. The first item shows additions and betterments financed by Canadian National Railways in the period 1923 to 1948, amounting to \$28,543,105. The fourth item shows the amount of rolling stock provided by Canadian National for Canadian Government Railways in this period, amounting to \$80,749,534. Those two items together make the \$110 million referred to in the President's statement, paragraph 4, at page 10."

And again at page 18505, Mr. Cooper said:

"I calculate these capital expenditures on Canadian Government Railways on which Canadian National is now paying interest amount to \$109,292,637. This amount of approximately \$110,000,000 is exclusive of lines acquired and new lines constructed in Canadian Government Railway territory, both of which matters are dealt with under Sections 5 and 6 of the Submission.

"It is our view, it has always been our view, that Canadian National should not have been burdened with interest on Canadian Government Railways capital expenditures. That is to say, the policy of the Government since confederation, should not have been changed merely because the railways were entrusted to the Canadian National for management."

THE CHAIRMAN: That is Mr. Cooper's statement?

MR. O'DONNELL: Yes, my lord.

COMMISSIONER ANGUS: I suppose that to round the picture out you would say that the Canadian Government Railways had no earning power.

MR. O'DONNELL: Possibly some of them were not expected to earn very considerable, and I think the evidence, as we come along to it; will show the position and justification of the position we take that we should not upon having been made the agent of the Government, been forced to find the capital and to pay interest on it when the Government had always done that during the time it operated these railways under the Department of Transport.

In further elaboration of the situation I think it might be well here to draw the attention of the Commission to the testimony of Mr. Cooper beginning at page 18501, which explains the attitude and gives the reasons. Mr. Cooper said:

"We take the position that we should not have been required to pay interest on the money spent on capital account for the Crown-owned railways. Prior to 1923 the Government Railways never paid interest on its invested capital. The railways were owned by the Crown, they were operated as a department of the Government and Government practice did not allocate the interest on the public debt to the various departments of Government. For example, interest is not charged against the Department of National Defence on the cost of ships in Naval Service or the aircraft used by the Air Force or the guns and other equipment needed by the Army. No interest is charged against Public Works Department on the cost of Government-owned buildings, including the one in which we are now sitting. The Post Office Department does not pay interest on the cost of all the post

offices scattered throughout the country; and so on. Nor was it the practice to charge the Transport Department interest on the money invested in the Intercolonial Railway, the National Transcontinental Railway, the Quebec Bridge, and things of that sort. In 1923 these Government railways were entrusted for management and operation to the Canadian National. The Canadian National is only an agent of the Government for the management of the railway. The ownership of the railway did not change. Why entrusting the management to an agent should make the agent responsible for interest which has never been charged when the Government itself operated the railway, I have never been able to understand."

THE CHAIRMAN: Who is saying all this?

MR. O'DONNELL: Mr. Cooper, my lord. He continues:

"The fact is that for several years after entrustment we objected to any interest charge and refused to accept such charge even though it was debited to us by the Government. What happened, however, is something like this, and you will have to take my word for it because I do not think the arrangement was ever written out. Under the Maritime Freight Rates Act, Section 6, there is the direction that the accounts for the Eastern Lines shall be kept separately from the accounts of the Canadian National and that any deficit on the Eastern Lines would be voted by Parliament separately from the vote for the Canadian National itself.

In consideration for the relief to Canadian National which this arrangement afforded -- ⁱⁿ that is, /having the deficit of the Eastern Lines taken out of the system figures -- Sir Henry Thornton agreed to finance future capital expenditures on the Canadian Government Railways. However, because of the recommendation in the Duff Report, paragraph 48, pages 17-18, and because of the views expressed by the members of the Parliamentary Committee on Canadian National affairs, the accounts for Eastern Lines were reinstated in the Accounts of the Railway System, but the quid pro quo, that is, the interest relief, which the railway enjoyed before the separation was made, was not restored, and the Canadian National was left responsible for interest on capital expenditures on Canadian Government Railways."

(Page 23860 follows)

It is relief from this item of interest, among others, that the Canadian National now proposes.

As to the second item on this tabulation under the heading "D", "Pension Fund", Mr. Cooper also testified, and his evidence is very brief and self-explanatory. It will be found in volume 99 at pages 18508-9:

"Q. I would just ask you, Mr. Cooper, if you would be good enough to explain that statement, and why that pension fund is more expensive to the Canadian National than the general pension fund?

A. The pensions paid under the I.C.R. pension fund are more generous than those paid under the main Canadian National pension plan. The two plans are different in many ways and it is difficult to make a complete comparison."

And again:

"It may be indicative if I say that under the Canadian National plan an employee who meets the service requirements and who has contributed five per cent of his wages since January 1, 1935, is assured of a pension equal to one per cent for each year of service of his annual earnings in the last ten years of service; whereas under the I.C.R. plan he would contribute one and a half per cent of his wages and receive a pension equal to one and a half per cent for each year of service of his average annual earnings in the last eight years of service.

The average monthly pension under the Canadian National plan, at the end of 1949, is \$45.40 whereas the average monthly pension being paid to retired Canadian Government Railway employees is \$84.61" -- just about double.

"An actuarial valuation of the I.C.R. and P.E.I.

provident fund has been made which shows that the liability of the fund for present and future pensions, to the extent that such pensions would be paid at the expense of the Canadian National, is \$59,600,000. It is estimated that the actuarial valuation of present and future pensions to this same group on a scale of the C.N.R. pension plan, to the extent such pensions would be paid at the expense of the Canadian National, would be \$33,200,000. The difference amounts to \$26,400,000. To be conservative, the estimate in the President's statement was placed at \$25,000,000."

Undoubtedly the pension plan on those figures of the Canadian Government Railways is far more costly than the pension plan of the Canadian National Railways, and the additional capital debt burden which the Canadian National Railways has had to assume and bear in virtue of that is conservatively estimated at \$25 million

COMMISSIONER INNIS: Does that include the National Transcontinental, or just the I.C.R.?

MR O'DONNELL: I think it is the I.C.R. and the P.E.I. I am informed that this applies to employees who started working in the Maritimes on the I.C.R. Now, where they are today, where they are working today, cannot be said, but they are entitled to come in under the plan, and under that plan they get much more generous benefits than if they had just started as Canadian National employees.

COMMISSIONER INNIS: So it is really pension fund I.C.R.?

MR O'DONNELL: That is really what it is, and P.E.I. That is quite an extensive difference, and by reason of being agent for the Government for the operation of Canadian Government Railways the National is expected

to find the money to pay those extremely more costly pensions.

That constitutes the explanation of the item under the heading "D. Canadian Government Railways", totalling \$135 million.

The next item on the tabulation is Item E; that is the heading "Effect of acquisition of unremunerative lines in national interest." That is a total item of \$170 million to begin with, and it breaks into four branches.

The first is the cost of acquisition of five lines of railway that are listed there, which were taken over, it will be remembered, in 1929, and comment is made on those in the Duff Report. They are as follows:

| | |
|--------------------|------------------|
| Inverness Rly. | \$ 375,000 |
| Kent Northern | 60,000 |
| Gaspé Lines | 3,500,000 |
| St. John & Quebec | 6,000,000 |
| Quebec, Mtl. & Sn. | <u>5,920,361</u> |
| | 15,855,361. |

Then there is the cost of rehabilitation of those lines; those two items, cost ^{of} acquisition and cost of rehabilitation, come to \$17,700,000-odd, rounded off at \$18,000,000.

Then the second branch of that item, "Increased operating expenses in connection with above lines", \$12,000,000.

The third is the item concerning Newfoundland Railway and Steamship Services, \$134,000,000.

The fourth, the Temiscouata Railway, estimated at \$6,000,000, and the total is \$170,000,000.

COMMISSIONER INNIS: Why don't you put the Temiscouata up in the other list?

MR O'DONNELL: Well, the Temiscouata and the Newfoundland, you will remember, Dr. Innis, were acquired by the Government and entrusted to us, whereas the others stand in our name. I think they are in a slightly different aspect. We got them in two different ways. The burden is there, none the less.

Mr. Gordon testified concerning this particular item of excessive capital burden of \$170,000,000 in volume 981 at page 18383, where he referred to the charge resulting from the acquisition of these unremunerative lines in the national interest.

As I have explained, these items do fall into those four branches. I intend to deal briefly with each one of them in turn.

Concerning the first item, the cost of acquisition of these five lines of railway, Mr. Gordon said, in volume 98 at page 18383:

"From time to time the Government has acquired and has caused to be incorporated in the National System, in the national interest, lines of railway which had little or no net earning power in themselves, which were in a run-down condition and required rehabilitation. The Canadian National income account was thereby adversely affected. These lines are as follows:

| | <u>Cost</u> | <u>Mileage</u> |
|------------------------------|---------------------|----------------|
| Inverness Railway & Coal Co. | \$ 375,000 | 60.8 |
| Kent Northern | 60,000 | 26.8 |
| Gaspé Lines | 3,500,000 | 202.3 |
| St. John & Quebec | 6,000,000 | 158.3 |
| Quebec, Montreal & Southern | <u>5,920,361</u> | <u>191.0</u> |
| | <u>\$15,855,361</u> | <u>639.2</u> |

COMMISSIONER INNIS: Those were not taken into the I.C.R., they were taken directly into the Canadian National?

MR O'DONNELL: That is correct.

COMMISSIONER INNIS: Even though they were in Cape Breton and I.C.R. territory?

MR O'DONNELL: That is my understanding, yes.

Continuing reading from Mr. Gordon's testimony:

"The cost of acquisition and of rehabilitation has amounted to about \$18,000,000."

Mr. Cooper confirmed Mr. Gordon's statement, and his testimony appears at the top of page 18510 in volume 99, where he said

"Our records show the cost of acquisition was, as stated, \$15,855,361; and if you include the cost of rehabilitation, the cost was \$17,766,799."

And he went on to say these figures are shown in Exhibit 221. That is that exhibit that I showed again; the details are listed right on the face of that exhibit.

Mr. Cooper agreed with the round figure of \$18 million used by Mr. Gordon, and then he supported the figures appearing on the record by referring to paragraph 60 of the Duff Report, on page 22 of the report, at the top of the page, the fourth or fifth sentence:

"In 1929, a further six short railways in Eastern Canada were taken over by the Canadian National Railways. The total cost of these railways, including the amounts spent on betterments and improvements, amounts to approximately \$35,000,000."

The sixth one we are not concerned with; it is mentioned in the Duff Report as the Montreal Tram Lines, and that is not included in these figures which form the item E on the tabulation which I have given you.

Further reference in the Duff Report is also made by Mr. Cooper at page 18512, where the Duff Commission, speaking of the taking over of the five railways referred to by Mr. Gordon, said in part:

" . . . but the Commission believes that it would have been better had the government assumed this burden directly and thus avoided saddling the railways with capital charges and operating expenses resulting from the purchase of railways based solely on a public policy."

THE CHAIRMAN: What paragraph is that

MR O'DONNELL: That is part of paragraph 61, the concluding words of paragraph 61.

This matter has been gone into before, but, as the Commission will remember, the Duff Commission, while noting all these things, said, "well, the time was not opportune, they thought, to rectify the situation, and there it has remained ever since. We submit now that the time has arrived and it should be rectified.

So much, then, for that first item under this item E.

As to the second item, the \$12,000,000, that is, increased operating expenses in connection with above lines, set out in the tabulation under the letter E, Mr. Gordon said, in volume 98 at page 18384:

"Incorporation of these lines in the System increased operating expenses applicable to each by reason of the obligation to pay wages at System levels and to assume pension liabilities, while on the other hand rates for transportation service had to be reduced. The effect of these changes was decidedly adverse to the net income of the System and constitutes another example of what has been termed negative capital. It is appro-

priate therefore to set up negative capital of \$12,000,000 which, added to the cost of acquisition and of rehabilitation totals \$30,000,000."

In explanation of this item of \$12,000,000, I would refer the Commission to Mr. Cooper's testimony in volume 99, beginning at the bottom of page 18513, where he said:

"A. I think the figure of \$12 million is quite conservative. We do not now keep the earnings of these railways separately, but we did so for a number of years subsequent to their acquisition. We have a record from 1929 to 1939 but we stopped compiling the figures after 1939 because of the war, because we had more important things to do. But I have a statement showing that in the eleven-year period the gross revenues for these five railways amounted to \$7,177,710 whereas their operating expenses were \$17,171,580, a net revenue deficiency of \$9,993,870. Those figures are exclusive of rent of equipment, et cetera. The figure of \$9,993,870 averages \$908,533 per annum which, capitalized at three per cent, exceeds \$30 million as compared with the figure of \$12 million used in the submission.

Q. That is why you said that in your view the \$12 million was an understatement?

A. Yes."

Now, Mr. Cooper produced Exhibit 222 at page 18514, a statement in corroboration of his figure in the estimate given by him, showing net revenue from railway operations 1929-1939, of the five lines acquired by the Canadian National to which he referred.

(Page 23869 follows)

That is this Exhibit which lists there again the details concerning the five lines, the gross revenue, the operating expenses, the net revenue, and it has five supporting sheets which set the matter out in detail according to the books of the company. I submit that Exhibit 222 is most clear, and that the supporting sheet for each of the five roads puts the matter beyond peradventure.

COMMISSIONER INNIS: To all intents and purposes they could be under the same classification as your co-ordination account, co-ordination cost, maintenance and operation?

MR. O'DONNELL: Well, the burden is there.

COMMISSIONER INNIS: It is there in both cases.

MR. O'DONNELL: We have to operate the lines and there is the situation which prevailed at the time we were given them, and the burden of operating them since is unquestioned for the period we have the accounts for. Mr. Cooper says: "Well, it is a very conservative figure in the light of the actual figures on record," which establishes in my respectful submission the item in full.

Now, the evidence of Mr. Fairweather in turn concerning this item, corroborates that of Mr. Gordon and Mr. Cooper, and it will be found in Vol. 103, commencing at page 19155. Having explained the operating disabilities and their decided adverse effect on the net income of the system, Mr. Fairweather gave us his opinion, and this is page 19156:-

"Q. Now, did you compute the \$12 million negative capital on the basis of \$400,000 a year?

"A. No, I discounted the figure of

\$400,000 by 10% to be on the safe side, and used a figure of \$360,000 as the adverse net effect, which, capitalized at 3%, gave me negative capital of \$12 million."

It is on this basis incidentally that Mr. Fairweather explained, it was at that time that he explained the meaning of the term "negative" as used by him and as found in Mr. Gordon's submission. Mr. Fairweather said at page 19156:-

"It is nothing but a graphic phrase expressing the amount of capital that you would have to have in reserve to produce by its interest return the amount of the disability in operating account that you are suffering.....the use of negative capital in this sense is simply a convenient way of evaluating the disabilities, that is all."

Then Mr. Cooper in Vol. 100, page 18709-10 said in cross-examination by Mr. Covert with regard to this term "negative":-

"It is really the capitalization of an annual deficit on the non-remunerative parts of the system."

Now, reference is made to the lines operated in the national interest at page 72 of the main Brief of the Canadian National formal submission, and in the terms that follow, and I quote in part:-

".....the financial burden carried by the Canadian National as a result of the losses attendant on the operation of these lines in the public interest is enormous and entirely beyond the earning power of

the balance of the property. The burden can be likened to and for all practical purposes constitutes a constant or fixed charge additional to that created by the bonded indebtedness."

THE CHAIRMAN: I was just going to ask you how you would name all these, and I find that is what you are doing now; the name you would give to this burden here, and you have answered me. You say that the burden can be likened to and for all practical purposes constitutes a constant or fixed charge - -

MR. O'DONNELL: That is right.

THE CHAIRMAN: Additional -- that is, you mean you are put to so much expense?

MR. O'DONNELL: That is right, and it is just as real an expense as the interest on the funded debt. The funded debt is there, that is outside the capital burden, it is there and that is - -

THE CHAIRMAN: So you ask us to consider this as a fixed charge under the Order-in-Council?

MR. O'DONNELL: That is right, we say that is what it amounts to.

THE CHAIRMAN: The same as interest?

MR. O'DONNELL: That is in effect what it is. We have to find money to make this disbursement and it is a constant continuing fixed charge which is as real as if it were provided for under a trust deed and was part of the bonded indebtedness as such. We cannot get away from that expense: there it is.

COMMISSIONER INNIS: You use there 3%.

MR. O'DONNELL: All the time with this computation we think it is fair to use 3%, and in some cases a rebated figure to be sure that we were on the safe

side and not asking for more than we should.

I think Mr. Fairweather said each time, for instance, this item of \$400 million -- he said he computed the \$12 million negative capital on a basis of \$400,000 a year. I asked him that and he said he discounted it by 10% and used a figure of \$360,000 and made the computation on that basis, so that it would not be an exaggerated amount.

Now, I might also, in passing, with respect to that aspect of the matter, refer to the statement made by counsel for Manitoba in his argument in Vol. 119 at page 21450, where he said:-

"It is recognized that the concept of negative capital introduced by the C.N.R. may have some merit as a financial device to offset losses on uneconomic lines."

THE CHAIRMAN: Would you please repeat that?

MR. O'DONNELL: "It is recognized that the concept of negative capital introduced by the C.N.R. may have some merit as a financial device to offset losses on uneconomic lines."

We say it is a fixed charge, negative in the way that Mr. Fairweather and Mr. Gordon used the term, but equally as real and equally as necessary to be met as the positive charges . . . provided by the interest on the bonds that are covered in the funded debt.

COMMISSIONER INNIS: Some merit the phrasing of rather varying meaning?

MR. O'DONNELL: Well, it is a matter for this tribunal to appreciate, everything being relevant.

THE CHAIRMAN: Suppose these lines became profitable all of a sudden.

MR. O'DONNELL: Well, there is that about it. That is something to weigh too, but ^{at} the present time, we say, there is the picture and part of our deficit which should be, as this Commission and other bodies have said, the Senate Committee of 1939, they have all said that those lines cannot be operated profitably. We say, in the circumstances, make some allowance, adjust the situation so ^{that} when you entrust these lines to us for management and operation, you don't ask us to go out and find the capital to provide the equipment and pay the pension fund and that sort of thing that run into such extensive amounts.

COMMISSIONER ANGUS: Do you really treat this as a fixed charge when you come to compare your fixed charges with those of other railways?

MR. O'DONNELL: Well, that I deal with as part of the over-all problem. On the basis of fixed charges themselves, you will note in this little tabulation that I gave you yesterday, is to come at a later time.

THE CHAIRMAN: I thought your answer was in the affirmative by what you said.

MR. O'DONNELL: There is no doubt about it. In this extensive capital burden that we point out of \$1,533 million, that we propose to settle with on what we consider a fair basis by compromising at \$1,060 million - -

THE CHAIRMAN: Are the companies with which you are comparing yourself in the same position as you, at least some of them to some extent? Have they also these losses, these unusual losses?

MR. O'DONNELL: In the full sense we have them in our respectful submission.

THE CHAIRMAN: I mean, you have examined it?

MR. O'DONNELL: Yes, that is our view. The only one - -

THE CHAIRMAN: How many companies have you taken into your - -

MR. O'DONNELL: They are mentioned in the Brief. We have taken for instance all the class 1 roads, we have referred to them in the main submission, and I am going to come to that at a later stage. But I would just say this, that we have not claimed anything for ordinarily thin traffic lines other than those that were imposed upon us in the national interest.

THE CHAIRMAN: I know.

MR. O'DONNELL: These five lines and Newfoundland and Temiscouata, those are the only ones.

COMMISSIONER ANGUS: I am not so sure that my question was quite clear to you. As I understand it, you eventually expect to be left with a fixed charge of something like \$15 million. Does that figure which was mentioned include such items as the \$360,000 a year for these unremunerative lines?

MR. O'DONNELL: Well, the fixed charge we would be left with would be the balance of the debt that is outstanding in the hands of the public for which they have those bonds.

COMMISSIONER ANGUS: Yes, so that this item would not come into that figure at all?

MR. O'DONNELL: Well, not in that particular way. This item comes in the computation, the tabulation that we have here.

COMMISSIONER ANGUS: For which you should get some consideration.

MR. O'DONNELL: For which we should get some

consideration. We are suggesting it be settled on the compromise basis whereby we take off half a billion dollars.

COMMISSIONER ANGUS: What is it you are going to compare the fixed charge with? Is it what you must pay on these bonds plus this type of liability?

MR. O'DONNELL: It is rather difficult for me to take that right at this point and deal with it, and if it would be of help I would ask you - -

THE CHAIRMAN: It is time to adjourn anyhow.

--At 1:00 p.m. the Commission adjourned until 2:45 p.m. today.

Ottawa, Ontario.
Wednesday, May 24, 1950.

AFTERNOON SESSION

ARGUMENT BY MR. O'DONNELL (Cont'd.)

THE CHAIRMAN: I think you were given a question to ponder over during the lunch time?

MR. O'DONNELL: Well, I do not remember that.

COMMISSIONER ANGUS: I think it was the one you postponed and said you were going to give us the answer later.

THE CHAIRMAN: I did not mean to hurry you.

MR. O'DONNELL: All I had in mind there was that on this tabulation I gave you yesterday, item 8 deals with all of that and that was all I had in mind.

What I want to do is to show the Commission how the claim that we say exists is made up and what it consists of and then at a later point in the argument I am going to come to that.

Now, I think that we were speaking of these lines which were operated in the national interest just at the adjournment and I was just about to say that it would be remembered that Mr. Fairweather gave his evidence with first hand knowledge of the situation having made or caused to be made under his directions studies on each of the five lines prior to their acquisition in the first instance and at a later date by way of a check and the five lines are those listed in item (e) on the tabulation here.

Now, as to the third item of this group, that is, the Newfoundland Railway and Steamship Services, Mr. Gordon referred to the recent entrustment to the Canadian National of the Newfoundland Railway and Steamship Services. As to this he said in Vol. 98 at p. 18384:

"It is anticipated that the operations of the Newfoundland Railway and Steamship Services will burden the System income account to the extent of \$4 million yearly. Expressed in terms of negative capital this amounts to \$134 million. Further, substantial amounts of capital will also be required from time to time to improve the property."

Now, Mr. Cooper gave evidence in support of Mr. Gordon's evidence and his evidence is as follows - it will be found in Vol. 99 at p. 18517. Mr. Cooper said:

"The figure of \$4 million is of course a forecast.

We only took the railway over on April 1, 1949, so that we have only nine months figures in our accounts so far. For the nine months ended December 31, 1949, the deficit was \$2,681,210. As these figures exclude the worst three months of the year and are exclusive of interest on the considerable capital expenditures which I understand will be necessary, I should think the figure of \$4 million is reasonable and can be supported. Our 1950 Budget, which will be submitted to Parliament this week, anticipates a loss on these items of \$4 million two hundred and fifty-two thousand, five hundred and eighty-nine.

Q. That is in the year 1950?

A. Yes sir.

Q. And this figure of \$4 million which Mr. Gordon's statement set forth is the prospective annual deficit which it is anticipated may result by reason of the taking over^{of} the Newfoundland Railway and Steamship Services by the Canadian National?

A. Yes, it is stated conservatively too."

Now, the views of Mr. George A. Walker, K.C., Chairman of the Board of Directors of the Canadian Pacific Railway, I submit, clearly support the Canadian National's contention that relief from compensation should be afforded it in connection with the operation of lines of railway such as the Newfoundland and Temiscouata.

THE CHAIRMAN: What did he say which you say supports that?

MR. O'DONNELL: I am just going to come to it, Mr. Chairman, but during his cross examination by Mr. Frowley, Mr. Walker was asked a question in Vol. 64 at p. 13458. In part, the thing reads:

"....Do you think that it is good business for the morale of the Canadian National as a corporation, or of its employees as individuals, or for the good of those parts of Canada which depend upon the Canadian National exclusively, that the railway should be burdened with the deficit of the Newfoundland Railway?"

The pertinent part of Mr. Walker's reply was: "I would not relish it if I were a Canadian National Officer. On the other hand, you know the Canadian Pacific has not always been governed by geniuses. We have made some bad investments."

Mr. Fairweather, who has special knowledge of the Newfoundland purchase discussed this item at length. He explained the difficulty of the operation and he said at Vol. 103 at p. 19158 :

"Anyone who knows the Newfoundland Railway and Steamship Services first-hand knows that it is a very essential service for Newfoundland. Anyone who would also quickly realize that if you tried to collect from the people of Newfoundland enough revenue to pay for those services the charges would

be fantastic as compared with the charges in the rest of Canada. That is the reason why this heavy deficit must be anticipated.

The Newfoundland Railway is a narrow-gauge railway, it traverses a very rugged country, where you no sooner climb out of one river valley than you plunge down into another, the grades on the Newfoundland Railway are about $2\frac{1}{2}\%$ and I think the curves run up to 15 or 16 degrees and the rise and fall (which is a technical term engineers use to describe the condition of a railway) is something out of this world.

In addition to the Railway there is a Steamship Service, coastal Steamship Service, which brings mail and merchandise and furnishes passenger accommodation to the outports, as they are called, along the coast of Newfoundland. It is a service which cannot conceivably be expected to pay its way because it requires a class of boat to combat the weather which is quite out of proportion to the traffic that would be offered.

For those reasons the unit cost of doing business in Newfoundland I should surmise would be easily - oh, I would think it would be three times the cost of doing business on the mainland. That is why we have contemplated a deficit."

(Page 23882 follows).

Also at page 19160, the following appears:

"Q. And your estimate there of \$4 million yearly in round figures, you have capitalized at 3 per cent again, as you did before

A. A. Producing \$134 million."

Now, the fourth item on this tabulation is that concerning the Temiscouata Railway. That is an item that relates to the operation of the Temiscouata resulting from the recent entrustment of that railway to the Canadian National, and it was mentioned by Mr. Gordon. As to this item he said, in volume 98, at page 18385:

"The operation of the Temiscouata Railway will constitute an additional burden on the Canadian National and will adversely affect its net annual income to the extent of \$180,000, the equivalent of \$6,000,000 in terms of negative capital."

This railway was acquired by the Government on December 10, 1949, when ratified by Parliament, Chapter 39, Second Session 1949. Order in Council P.C. 635, dated February 10, 1950, stipulates January 1, 1950, as the date of entrustment -- volume 99, page 18518.

The situation relating to this railway is again one with respect to which Mr. Fairweather had first-hand knowledge, he having made a study of it, as you will remember, prior to its acquisition by the Government and its entrustment for operation by the Canadian National. At page 19161 in volume 103 Mr. Fairweather said:

"This particular line was bought by His Majesty. The history of this particular line is that it too started to run down when revenues were inadequate to meet expenses. I may say that both the Canadian National and the Canadian Pacific Railway tempered their treatment of this line to keep it afloat, and,

notwithstanding that, in the post-war period the situation developed where it got into very, very serious difficulty. The study I made indicates that the incorporation of this line into the Canadian National System produces about \$180,000 a year adverse effect. That is after taking into account all of the items which I have dealt with in the examples of the Gaspe Railway and the Kent Northern Railway, and in this case in addition to that the interest on rehabilitation, because the rehabilitation cost is not shown separately in the brief, so in this case the interest on rehabilitation is included. It produces a condition of \$180,000 adverse effect. It may be of interest to you to know that in this particular case the rate reductions amounted to \$159,000. I happen to have the figures here."

COMMISSIONER INNIS: Have you worked out the comparable bases for these other lines -- that is to say, deficits and then capitalizing the deficits?

MR O'DONNELL: The other five all together?

COMMISSIONER INNIS: Yes.

MR O'DONNELL: I think what was done was to take the cost of acquisition and then the rehabilitation and then work out separately operating expenses in connection with them, and that is the figure of \$12 million which is in that item 2 under the heading "E".

COMMISSIONER INNIS: I was wondering whether you were getting double counting.

MR O'DONNELL: I do not think there is double counting, because the Newfoundland and Temiscouata are separate altogether; they are apart from those.

COMMISSIONER INNIS: Yes, they are, but in the case of the Temiscouata, as I understand it, you capitalize

whatever the deficit is -- \$180,000, is it?

MR O'DONNELL: That is right.

COMMISSIONER INNIS: \$6 million.

MR O'DONNELL: Yes.

COMMISSIONER INNIS: Now, if you had similar deficits on these other lines -- have you any figures indicating what the deficit is?

MR O'DONNELL: The figures are those given by Mr. Fairweather.

COMMISSIONER INNIS: These are cost of acquisition.

MR O'DONNELL: Yes, and you will notice there we have split the cost of acquisition first on that tabulation, cost of acquisition and the cost of rehabilitation, then the next item, operating expenses in connection with above lines, \$12 million. It deals with that bracket. Now, the other two, Newfoundland and Temiscouata, are handled on their own separate basis; they have nothing to do with the first five. These last two are on their own basis altogether, and have nothing to do with the first five.

COMMISSIONER INNIS: Well, I was wondering, when you were totalling them all up together, whether you were not using different bases for arriving at your calculations, whereas one might try to get the same bases.

MR O'DONNELL: Well, I think what they have done -- for instance, they have taken the Newfoundland operation; they know what that is, what it has produced in the past and what it is doing now, and they make an estimate on that. They take the Temiscouata then, and they know what that has cost and is costing, and they capitalize that. Now, those two are absolutely distinct and apart from the other five which are dealt with in the first two items, the two headings, and as a matter of fact they are split

into three subjects. The cost of acquisition, first, is \$15.8 million, the cost of rehabilitation \$1.9 million, and that is rounded off as a total of \$18 million. Then, having acquired and rehabilitated them, they have to operate them, and the increased operating expenses in connection with those five are capitalized at the \$12 million, as explained by the evidence I read into the record this morning. I do not think there is any duplication there, Dr. Innis.

COMMISSIONER INNIS: Well, I would like to look into it.

MR O'DONNELL: Well, I am satisfied in my own mind, anyway, that we have treated those two as distinct items. We just have them relatively recently, and they have in no way been computed to form part of the other items.

Now, Mr. Fairweather's computation of the adverse net result and the annual amount of \$180,000 or the equivalent of \$6 million negative capital, I submit, has not been challenged, and it stands there on the record as representing what the facts are in his view.

As to the Temiscouata Railway, Mr. Walker agreed (vol. 64, p. 13453) that the Board of Directors of his company -- I quote his words --

"would never have passed a resolution for the taking over of that railway".

And again:

"Not as a business proposition, no."

Mr. Walker also replied in the negative to Mr. Frawley's further question which appears at page 13453:

"But if you had an opportunity to take it or not to take it, you would not have much difficulty in making up your mind?"

He certainly was very definite about that.

Further, again at page 13454, he is asked:

"Q. How long has it been since you bought another railroad like the Temiscouata?

A. We have not bought anything at all.

Q. . . . Now I put it to you as an experienced railroad executive: Do you think it is good enough for the building up of the morale of the Canadian National, or is it good enough for the building up of our country that the feeling should go abroad that the Canadian National is just a catch basin for bankrupt roads?

A. I think it is quite wrong."

Again, Mr. Walker's evidence, I respectfully submit, fully supports the claim advanced by the Canadian National with respect to this item, and the Newfoundland item is in the same category as are the five other lines which were commented upon by the Duff Report. Undoubtedly, I respectfully submit, compensation, relief, adjustment -- call it what you will -- should be recommended with respect to these items.

Now, that covers the item under the letter "E" on the tabulation and the various factors which total the \$170 million. The next---

COMMISSIONER INNIS: Coming back to this again, this \$12 million item, have you a breakdown as to the different lines and the operating deficits, I presume, of these five lines which go to make this up?

MR O'DONNELL: Well, you will remember, Dr. Innis, that Mr. Cooper said that we had the figures on this Exhibit 222 for the eleven years 1929-1939. We have got the detailed information there, the red figures on each one of them, but from 1939 on when the war broke out they

stopped keeping them. But there is the detail, year by year, with respect to each one of those five roads, giving gross revenues, operating expenses and the net, and showing a continuous deficit on each one of those lines.

COMMISSIONER INNIS: They work out at \$908,000, I think you told us.

MR O'DONNELL: Well, they work at whatever we say on the---

COMMISSIONER INNIS: I think it was \$908,000.

MR O'DONNELL: Yes; it is capitalized and rounded off at \$12 million.

THE CHAIRMAN: Is that Exhibit 211?

MR O'DONNELL: That is Exhibit 222, my lord. Exhibit 221 has reference also to those five lines, and it shows the cost of acquisition and the cost of rehabilitation. On Exhibit 221 you will see the figure \$17,766,799, which is the figure shown on that tabulation that I gave your lordship this morning under item 1 under the letter "E".

(Page 23889 follows)

Then the details of the operation of those five lines are set out in Exhibit 222. Is there anything else?

COMMISSIONER INNIS: No.

MR. O'DONNELL: The next item I should like to come to is the item against the letter E in the tabulation, effect of development lines.

THE CHAIRMAN: That is under the letter F in my copy.

MR. O'DONNELL: You are right, my lord. It should be F. It is that item of \$34 million. As to the excessive Debt Burden upon the Canadian National resulting from this item, Mr. Gordon said at Vol. 98, p. 18385:

"Large amounts of capital have been spent upon development branchlines, the whole cost of which by necessity has been provided by the issue of interest bearing obligations, whereas in sound financing procedures, a substantial percentage of the cost should have taken the form of equity financing. The amounts so expended total \$85 million, and if a minimum of 40% be taken as the amount which should represent equity capital, the capital burden of the Canadian National is in this respect excessive to the extent of \$34 million."

In corroborating this figure, Mr. Cooper referred to p. 41 of the main brief, Exhibit 214; and his testimony in this connection will be found at page 18520, Vol. 99, in the following language:

"On page 41 of Exhibit 214, you will see the first item shows new lines constructed in the period 1923-1947 to be \$83,754,321. We spent in the period 1923 - 1947 \$83,754,321 in constructing new lines of railway. In 1948, we spent \$1,414,549 in the construction of the ^{Barraute} branch line."

Page 20, Exhibit 217. Mr. Cooper said at page 18521:

"I cannot imagine a private railway building 85 miles of branch lines in this period. Not of the type these branch lines are."

And he gives ^{as} his opinion, at page 18522; that at least -

"....forty per cent of the capital expended in the development of branch lines should take the form of equity capital."

Mr. Fairweather also testified concerning this subject and its adverse effect on the Canadian National, and his evidence will be found in Vol. 103 beginning at page 19163 and continuing to page 19172. I will read only a short extract. He says in part at page 19172:

"In this \$85 million there are amounts with regard to lines which in the 1920's were considered as desirable in the national interest."

The excessive capital debt burden with respect to the total amount of \$85 million expended on development lines was fixed at \$34 million, the sum mentioned ^{by} both by Mr. Gordon and Mr. Cooper.

In connection with this particular item, the Commission I think will remember Mr. Norman suggest development lines of this kind or development lines generally, if they were of a commercial nature - and he had some difficulty in determining which were commercial and which were not commercial, and I will come to that later. He indicated that they should be financed in the ordinary way; that is, to secure the equity capital through the issue of securities. But the Commission will remember this. In the case of the Canadian National, that is impossible because under the Canadian National Railways Act, the only equity holder can be the government. The government is the only person that can have stock in the Canadian National Railways.

THE CHAIRMAN: How is that expressed?

MR. O'DONNELL: Section 5 of the Canadian National Railways Act reads that

"The Governor in Council may declare that a company shall have capital stock with or without shares, of such amount as may from time to time be deemed expedient; and (2) all such stock shall, unless otherwise ordered by the Governor in Council, be vested in the Minister of Finance on behalf of His Majesty.

The Canadian National is not in a position to offer stock on the market and do the type of finances that Mr. Norman suggested.

THE CHAIRMAN: You just read there "unless otherwise ordered."

MR. O'DONNELL: Yes, that is right.

THE CHAIRMAN: Can you tell me what Parliament had in mind when they put that "unless" phrase in there?

MR. O'DONNELL: No, not off hand.

THE CHAIRMAN: Is there nothing shown in the debates?

MR. O'DONNELL: No, not on that. The intention, I presume, was that the government would be the sole owner of these railways and that they would be operated as an entity. That is the recommendation.

THE CHAIRMAN: I am asking you about that phrase. Do you see the part of the sentence beginning with "unless otherwise ordered"?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Would you tell me what force was meant to be given to that phrase?

MR. O'DONNELL: I do not think they ever intended that there would be public issues.

THE CHAIRMAN: Read it again.

MR. O'DONNELL: Yes. My offhand suggestion to that would be --

THE CHAIRMAN: Would you read it again?

MR. O'DONNELL: My suggestion would be that it might be to qualify a director or something of that kind. But otherwise the government is to own it. The second part of Section 5, the second paragraph, reads as follows:

"All such stock shall, unless otherwise ordered by the Governor in Council, be vested in the Minister of Finance on behalf of His Majesty.

There were occasions possibly where they wanted to rest it in somebody other than the Minister of Finance, to hold it, or something of that kind. That is the only thing that I can think of offhand. But under the Statute it is not intended that there should be public issues of Canadian National Railways stock. In the circumstances the Canadian National Railway cannot finance--

THE CHAIRMAN: As a matter of fact, no Order otherwise has ever been made?

MR. O'DONNELL: I do not think so; None that I know of, anyway. And the intention is, I am satisfied, that the government was to own this company or to operate this company, or rather the company was to be carried ^{on} through the corporate set up, the stock to be owned by the government.

THE CHAIRMAN: We have that Act here in this, have we?

MR. O'DONNELL: Yes.

THE CHAIRMAN: At what page?

MR. O'DONNELL: I think it is the first one. It is in consolidated form, the first one. It is on the second or third page.

THE CHAIRMAN: And what is the section you have just read?

MR. O'DONNELL: Section 5, my lord. It is chapter 172 of the Revised Statutes of Canada, 1927.

THE CHAIRMAN: I note that the word is "until", not "unless", ^{as it appeared} according to the way you have put it:

"All such stock, shall, until otherwise ordered by the Governor in Council be vested in the Minister of Finance on behalf of His Majesty".

MR. O'DONNELL: "Until," yes. I read "unless". It is "until".

THE CHAIRMAN: That would sound as if there was an expectation of something else being thought advisable.

MR. O'DONNELL: It left it open. They may have wished to transfer the stock from, say, the Minister of Finance to the Minister of Transport; I do not know. That may be the reason for that. But in the meantime it is vested in the Minister of Finance.

In connection with that type of thing, and the adverse effect which it has on the Canadian National --

THE CHAIRMAN: Has there ever been a declaration made under the first subsection of section 5?

MR. O'DONNELL: Have what?

THE CHAIRMAN: A declaration being made. I am sorry that I cannot speak louder.

MR. O'DONNELL: That is all right.

THE CHAIRMAN: The section says:

"The Governor in Council may declare that the company shall have a capital stock, with or without shares, to such amount as may from time to time be deemed expedient."

Have different declarations been made?

MR. O'DONNELL: I think at the time of the Revision ^{Capital} Act there was a change in the number of shares and the method.

(Page 23896 follows).

MR. O'DONNELL: I think at the time of the Capital Revision Act there was a change in the number of shares and the method - -

THE CHAIRMAN: By Statute, yes, but I was just wondering what the Governor-in-Council -- please don't lose time over it.

MR. O'DONNELL: I think that summary I mentioned to your lordship this morning gives the story very completely, Vol. 109, p. 20026.

THE CHAIRMAN: Anyhow, this much is clear, isn't it, that all the equity capital of the company is owned by the Government?

MR. O'DONNELL: That is right, and I was merely saying that to suggest that we should finance by public issues and acquire our equity capital as other companies do by issuing securities, in our case cannot be done, and that is why I suggest - -

THE CHAIRMAN: Why do you say it cannot be done?

MR. O'DONNELL: Because under the Act we are not allowed to issue stock.

THE CHAIRMAN: You are not allowed

MR. O'DONNELL: No, but the Governor-in-Council - -

THE CHAIRMAN: The Governor-in-Council can do something about it.

MR. O'DONNELL: He may be able to do something about it but we cannot.

THE CHAIRMAN: You cannot.

MR. O'DONNELL: And that is the short answer to Mr. Norman's suggestion that if you want to finance the development lines, issue some stock and procure the money outside. It just cannot be done.

THE CHAIRMAN: Of course naturally it is the owner of the enterprise who would have to take any necessary action, and the owner is in the ordinary case, in the ordinary company would be the shareholders, the majority of them. In this case it is the Government because it is the only shareholder.

MR. O'DONNELL: That is right, and the Governor-in-Council acts where the shareholders would ordinarily act, under the Statute. But I am saying this, as was pointed out by the Right Honourable Mr. Manion in 1932, the effect of that thing is that the Canadian National (and I quote from his remarks in debate at page 2771):-

"The Canadian National Railways being a Government road, has been for many years borrowing its money upon bonds, while many of the private companies, including Canadian Pacific, have been raising the hundreds of millions of dollars which they have put into the roadbed and equipment, by stocks of one kind and another. On these stocks, fortunately for the privately owned railways, they may discontinue, and in some cases they have discontinued, the payment of dividends; whereas on the bonds of the Canadian National Railways, the payment of interest to the investing public cannot be discontinued without repudiating our debt as a Government."

That ties in with the situation as we have it. If we, with the heavy funded indebtedness we have, do not meet our interest, we are in a deficit position.

On the other hand, the Canadian Pacific, for instance, if it does not happen in any given year to earn it, it simply does not declare a dividend. I think there is a tremendous difference between the two insofar as reflection is concerned. I think there is far less, as I think I put it the other day, far less of a stigma in not declaring a dividend than there is in defaulting on the interest.

COMMISSIONER ANGUS: But in prosperous years, doesn't it work the other way round, that you are paying less for your capital than the Canadian Pacific is?

MR. O'DONNELL: Well, that may be in some respects, but we have to take the good with the bad. If you are going to complain that we get our capital at too low a rate, that is something to be thought of when the high dividend is being paid.

COMMISSIONER ANGUS: Wasn't Mr. Fairweather's evidence that these lines were not built unless it was anticipated that they would repay their full cost?

MR. O'DONNELL: Ultimately, some of them, yes, but over a long period of years, and he said it might sometimes be ten or fifteen years before they do produce. I think he wanted to say that they did not build lines without any ultimate hope of realizing something on them.

COMMISSIONER ANGUS: But that was careful calculation?

MR. O'DONNELL: Absolutely, but it was not going to begin to pay the day the road was completed. In the meantime the money has to be found, and the only way the Canadian National has been able to find it has been by paying interest on it.

COMMISSIONER INNIS: In that case this is only a temporary item, isn't it?

MR. O'DONNELL: The ones we are talking about here are those that have accrued to date, and those that we are talking about there. We say that instead of having to find \$805 million all of which had to be borrowed, that some proportion of it (and 40% seems reasonable on the evidence even of men like Mr. Northey Jones and these other people) that 40% should be equity. Then some consideration should be given to the Canadian National by reason of the fact that it was all borrowed.

COMMISSIONER ANGUS: I fully agree that your fixed charges have gone up unusually fast, but is not the counter evidence that your revenue has done so too if expectations were realized?

MR. O'DONNELL: All that has been taken into consideration, as I understand it, in this proposal, and it is on the facts as we know them today and on the past record and what we can expect for the future, weighing all these things, how it has been with the road in forty odd years and the determination of everyone who has considered this problem: taking all those into consideration, the amount of relief that we need in order to give us what we say is a very modest chance to get along, is \$1,060 million in settlement of this excessive capital debt burden of \$1,533 million which we have shown exists on the evidence we have put before the Commission .

COMMISSIONER INNIS: There is no negative capital in this \$34 million?

MR. O'DONNELL: No, I don't think -- this is the claim on its own facts. We simply say that having been forced to borrow money - -

COMMISSIONER INNIS: Yes, but you are not including any deficits on the lines, capitalizing these deficits?

MR. O'DONNELL: No, no.

COMMISSIONER INNIS: It is simply a matter of straight borrowing?

MR. O'DONNELL: We say that if we had been permitted to get money in the equity market, it would have been \$34 million less than it has cost us today.

COMMISSIONER INNIS: Have you the figures of the amount the Government paid for the Newfoundland and Temiscouata Railways?

MR. O'DONNELL: No, I don't think we have. We got the roads from the Government under the entrusting order.

COMMISSIONER INNIS: I was wondering if you had them at your fingertips?

MR. O'DONNELL: I have never seen them; I don't know that they have been disclosed to our people. Under the Terms of Union I think there is reference to the Newfoundland Railway, but I don't know that there is any figure given. Our position on that, Dr. Innis, is that the Government bought the road under the Terms of Union.

COMMISSIONER INNIS: I know, but there is one point which is apt to be a little obscure. One sees the Canadian National situation; one does not see the Canadian Government situation; and unless one had some indication as to what interest was being paid on the amount which has been paid, one would tend to get a bad comparison from the standpoint of the Government.

MR. O'DONNELL: As far as the railway as a railway is concerned, we were given this railroad to operate, and it places that burden on us annually.

THE CHAIRMAN: You don't know how much the Government of Canada paid for it or anything?

MR. O'DONNELL: I don't personally at this time, and I don't know that it is a matter of public record.

THE CHAIRMAN: No, but it has been handed to you as entrusted under that particular section of the Act, would you say? Has it been entrusted, is that so?

MR. O'DONNELL: It is transferred to us for operation under the Order-in-Council.

THE CHAIRMAN: I know, but transferred in what way? Not transferred the way the Hudson Bay Railway is, is it?

MR. O'DONNELL: No, the Newfoundaand Railway situation is set out in P.C. 1454 as far as we are concerned, that is the Order-in-Council of 1st April, 1949.

THE CHAIRMAN: Now, I am asking you, is that an order of entrustment? I thought it was.

MR. O'DONNELL: Yes, it is entrusted to us for operating purposes.

THE CHAIRMAN: You remember, in the Act the word "entrustment" is used?

MR. O'DONNELL: That is right.

THE CHAIRMAN: And it is one of those lines, is it?

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: Here then is a line which has been entrusted to you. You don't know what it cost the Government to acquire it, but you know what it is going to cost you to operate it?

MR. O'DONNELL: That is it, and we say simply: you have put a burden on us in transferring this line.

to us of \$134 million, and we should be given some consideration for it.

THE CHAIRMAN: Now, Mr. O'Donnell, before you go on any further, just for the sake of ready reference, at the foot of this detailed page of yours where you have a total of \$1,533 million - -

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: Just now you stated a new figure that would turn out if - -

MR. O'DONNELL: Yes, that is what I am coming to next. We say that is the claim - -

THE CHAIRMAN: Just give me the figure.

MR. O'DONNELL: \$1,060 million.

THE CHAIRMAN: Now, what you are asking for would reduce that figure to the new amount, is that it?

MR. O'DONNELL: That is right. We say the total claim is \$1,533 million. We say we have weighed it all, looked at the picture as far as we can determine to get to what would be a reasonable compromise at this very late date. We say that this thing goes back to 1923 even and beyond that. There is a \$804 million item there which in 1923 would have been either written off or, at the best, transferred into equity capital, and so on. We say that is what we should ask for and expect to receive if we got 100% of what we think should be given to us. But in the circumstances, if you, the owner, will do this, then we will settle it for a total amount of \$1,060 million. I am coming to that to discuss the manner in which we propose that should be done.

My friend Mr. Friel points out that is about a 69% discount for cash, I suppose.

COMMISSIONER INNIS: How about the Canadian Pacific's discount? Is that 60% too?

MR. O'DONNELL: I think I had just said that Mr. Fairweather pointed out that in the \$85 million that he referred to in connection with effect of development lines that the excess in capital debt burden which resulted from having to do the financing from interest bearing securities amounted to \$34 million and that makes up the total - those items when added - a, b, c, d, e, and f on the tabulation, they give a figure of \$1,533,000,000.

Now, the Commission will remember that when Mr. Gordon had reviewed in detail these various items - that is Vol. 98 p. 18386 he said:

"This statement evidencing excessive capital burden of \$1, 533,000,000 (which is in excess of the Fixed Charge Debt of Canadian National of some \$1,344,000,000) supports the conclusion that an undue portion of the capital invested in the Canadian National System is represented by interest-bearing securities."

Now, that is the position as put concerning that. Now, having demonstrated, we say, the manner in which the said excessive capital burden of \$1,533,000,000 was constituted (and I emphasize again that no attack whatsoever was made upon that total or upon any of the constituent parts) and having indicated that that is the claim, it now behooves us, I think, to examine the matter.

THE CHAIRMAN: No attack by whom?

MR. O'DONNELL: No one questioned the evidence, no one led evidence to contradict the witnesses and there is their evidence and that is the only evidence.

COMMISSIONER ANGUS: The taxpayer had no counsel.

MR. O'DONNELL: The taxpayer had no counsel but the Commission had counsel and there were other counsel in the room and the taxpayer's counsel would be the Commission counsel in this point, I think. Anyway, my submission is that there is the only evidence you have before the Commission and it warrants this figure that we have of \$1,533,000,000.

Now, having indicated that that is the claim we now, I think, might examine the method or the measure which the Canadian National submits is required to provide adequate relief from the excessive and, we say, unjustified capital debt burden.

Now, it will be remembered that Mr. Gordon said that in his considered opinion, concurred in by the Board of Directors, nothing short of the measures which were put forward in the proposal could be deemed adequate treatment of the capital structure of the Canadian National. He said:

"This measure, if put into effect should enable the Canadian National on the average to meet its fixed charges including its interest on funded debt."

That is page 18388.

THE CHAIRMAN: Are you now coming to paragraph 6 on page 2?

MR. O'DONNELL: I am just ending the summary at the bottom of the other page and I now come to the paragraph which your lordship has just referred to, number 6.

Now, having shown what the claim is, how then is the relationship between the Government and the Canadian National ^{under} / which the Canadian national carries this unjust burden of \$1,533,000,000 of interest-bearing debt to be adjusted between the only two parties concerned in

the matter - in my respectful view, the Government and the Railway?

The circumstances actually are that the railway has a claim against the government for \$1,533,000,000 which we respectfully suggest has been the major portion which has lain there for too long a time and should be settled. It has been hanging too long. Everybody who has examined it through the years has said so. The Duff Commission acknowledged the point and said that it was over-capitalized and it should be adjusted but they said that the time was not opportune and we say that the time is now opportune and we say this is the time. This is the first real occasion on which any tribunal has been specifically charged with the responsibility of recommending proposals for the solution of the financial difficulties of the Canadian National.

I say much was said on the subject over the years. One is apt to be confused by what are more its apperents, then its real complexities. The matter however is simple in principle. It can be reduced to the mere satisfaction of the railway's claim against the government by a very simple transection between these two bodies themselves.

Now, admittedly it is extremely difficult at this time to analyse with arithmetical exactitude and accuracy, the figure at which this claim should be settled, owing to the lengthy period of time to which it relates. On the other hand, for all practical purposes, and with equally beneficial results as if the matter had been studied in scientific detail, it is possible to strike a reasonably satisfactory compromise figure. The matter has, in fact, as is quite apparent from the detailed evidence submitted to your Commission by the responsible Executive Officers of the Canadian National Railways, been considered very carefully by them and the Board of Directors.

After mature deliberation, the conclusion has been reached that it should be disposed of on a compromise basis and through Mr. Gordon, the Canadian National has stated that it is prepared to take an adjustment which would involve "payment", so to speak, by the Government to the railway, of \$1,060,000,000.

Now, that is the way we approach it and it is simple as far as we are concerned.

THE CHAIRMAN: Do you really think it is the realistic way? You see, here the Government owns the railway. They are the sole shareholders of the company that operates a railway and in fact it is asking us what we think should best be done with this railway. It asks us whether it is advisable to put it on a certain basis insofar as its fixed charges are concerned. You think it is realistic to make it an issue between you and the government, that is to say, between the company and its shareholder if they were not in the plural?

MR. O'DONNELL: Well, I think it is realistic for the management of the company to go to a shareholders meeting and its Board of Directors to go to a shareholders meeting and say: "This company is badly in need of adjustment. You, the owners can adjust it and we suggest that you do it in order to get it on a reasonable business-like basis". That is all we are saying.

THE CHAIRMAN: You are making recommendations through us to those who own the railway?

MR. O'DONNELL: That is all and those who own it have appointed you, my lord, and the Commission to look into this and weight it and see whether it is right or wrong.

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THE CHAIRMAN: I wondered if you should suggest a compromise between you and the Government?

MR. O'DONNELL: When I say "compromise" I mean this, that if it were possible to have the accounts added up to a cent --

THE CHAIRMAN: I said the word "compromise". I just wanted to be sure that my mind was travelling on the right plane, so to speak. The Government owns this company - nobody else. The only other claimants against it are the security holders among the public and your company manages and operates this railway which is the property of the Government because the Government is the only shareholder. Now then, you are appearing before your shareholders through us and you are making a request which you think is in the interest of ^{the} operators and of the Government, the owner?

MR. O'DONNELL: We are saying simply to the owner: "You might as well face the fact. Others have said that now over the years, that an adjustment is needed, that this company that you have set up to do the job is top heavy as far as fixed charges and interest-bearing burdens are concerned and it should be adjusted".

Now, that has been said through the years and I have a number of opinions and remarks by people who were actively concerned with the thing at different stages to that effect. I intend to put them before the Commission and the Commission can weigh them but we have all parties through the years agreeing that that should be done and always for some reason or another it was put off and the advantages of having the settlement made and having the thing put on a business-like basis have been commented upon many, many times and we think that when we come forward with this proposal, which, as we say, is something that the

Government is in a position to do and which, if it chooses, - after all, I agree with your lordship it is the owner and it may not want to do what the management and the directors think should be done but, you see, when this company was set up the intention was that it was going to be given an opportunity to live, to carry on, to do business in a business-like way.

Mr. Arthur Meighen who introduced this bill in 1919 made these remarks on the 24th of April, 1919 speaking of this company:

"It seems to me to be a very real company. We want to make it a real company but it will be a very unreal company if one half is to be departmental and one half corporate".

That is another aspect I am speaking to in a moment. That refers to the fact that Government railways at the time were operated by the department. His idea was that they should be put into the Canadian National as they ultimately were.

"I do think that while it is true that this is in reality a Government enterprise, it is equally true that we are trying to operate it as a business concern under corporate management".

Now, on the question "a business concern under corporate management" - another very eminent business man, a lawyer, a man who was the Prime Minister - the Right Honourable R. B. Bennett, had this to say about this type of thing and the adjustment we are asking for. He spoke in 1933, on Feb. 28th, I think it is.. Mr. Bennett said:

:"Now, what would happen under normal conditions if this were a private enterprise having defaulted in the payment of its obligations? What would happen

would be that which took place in the case of the Grand Trunk Pacific. An application would be made to the Exchequer Court to appoint a receiver, the Directors would pass out of existence, the receiver would take charge and would operate the system for the benefit of the bondholders or creditors of the road (I am leaving out unimportant words). Under normal conditions a receiver would be appointed by the Court. But there can be no receiver where you have the provinces and the Dominion with their guarantees. The Crown cannot default; the Dominion and the Provinces must pay or else their credit is done.....

Under normal conditions the effect of a receivership.....is that interest is no longer paid and all the revenues are available to rehabilitate the System and bring about its reorganization..... the Great Milwaukee System went into receivership, as did Northern Pacific, the Union Pacific, the Santa Fe, the Wabash, and the Chicago and Great Western. All these roads went into the hands of receivers and during the period of the receivership the security holders got no interest on their money. But you cannot do that in connection with our roads because the Provinces have given their guarantee and the Dominion has given its guarantee as well the legal necessity, together with the powers of controlling management, to bring about that equilibrium between income and outlay that is the aim of every receiver before a reorganization takes places."

He is simply saying there that if they had been put to bankruptcy they would have been established on a reasonable basis before they were turned over to this new corporation. If that had been done, we would not have had the \$800 million of interest-bearing debt at the outset.

The Honourable Mr. J. L. Ralston also had remarked concerning this type of thing. He said:

"Now, it is absolutely a contradiction in terms if you talk about remunerative operations with a capitalization of \$2,286,000,000. There are two ways to securing economy.....there are two ways we propose to achieve it, one by forcible cooperation with the competitive railway, and the other.....by making the railway a dependent not only of Parliament but of the public too". And he went on to say:

"I submit (and this is page 2976 of the Debate at that time) - I submit we might just as well decide now that the people of Canada will cut their loss---"

THE CHAIRMAN: Cut their what?

MR. O'DONNELL: Cut their loss.

"..... it is a loss in connection with the Canadian National, and do what almost every other concern is doing, have a reorganization, cut down fixed charges and give this railway a chance to live and pay its way. I have always felt, particularly when we talked about the change in management in the System that these would be the first thing to be done. I cannot conceive how you are going to put trustees in charge of this road and tell them to run it on the principle laid down in Section 16, "remunerative operation" without fixing some decent amount of capital on which the railway is supposed to pay interest."

I have a number of others along the same line, but throughout the years it has been suggested that this thing should be done, and all I am saying at this point is that the proposal that we now make is one under which it can be done easily at this time between the only two entities involved in it. As your lordship said, how can you suggest a compromise with the owner? We are not trying to tell the owner that he must do this; we are saying that we think he should in order to put it on the basis that will let it be a real company, as was referred to by Mr. Meighen, and let the public see finally that it is doing the job that it was set out to do, and that if these ancient historical debts be taken off its back it can continue to operate with results that would be far more pleasing to those who are charged with the operation.

THE CHAIRMAN: What relief did you get on previous occasions?

MR O'DONNELL: The Capital Revision Act? Well, all the Capital Revision Act did was to eliminate from the balance sheet certain operating deficits upon which interest even had been accrued. The deficits were capitalized and interest was charged on them, and all the bookkeepers, accountants and experts said that that was not any proper way to do things and that those should be eliminated from the balance sheet, it had nothing to do with this type of thing at all.

THE CHAIRMAN: You just quoted the Prime Minister in 1933 and Mr. Rolston agreeing that certain things ought to be done in order to put your railway in a proper position; what was done then?

MR O'DONNELL: Well, what was done was what was done under the Capital Revision Act. I am going to come

to that.

THE CHAIRMAN: Is that the same year?

MR O'DONNELL: No, the Capital Revision Act is 1937; and 1937, Mr. Cooper said, dealt only with one portion of the picture; it did not deal with what we are talking about at all; it did not go that far. The Duff Commission recommendations were not carried out in the respect that we are speaking of.

THE CHAIRMAN: From the speeches that you just read to us there, it would look as if those who were speaking thought that what was about to be done would be sufficient to----

MR O'DONNELL: In that last speech, when Colonel Ralston made those remarks, he was speaking of the C.N.-C.P. Co-operation Act, and I am citing that by reason of his appreciation of what the situation was and what it required by way of an adjustment.

THE CHAIRMAN: What was the Prime Minister speaking of?

MR O'DONNELL: Well, that was in the same debate, my lord.

THE CHAIRMAN: I know; they went much further than the co-operation. They seem to have had in mind the necessity of putting your railway on a proper basis.

MR O'DONNELL: Yes.

THE CHAIRMAN: Did what they put into effect then seem to meet the case at that time?

MR O'DONNELL: No, no. That debate was on the C.N.-C.P. Act, and your lordship knows what the C.N.-C.P. Act did.

THE CHAIRMAN: The Co-operation Act.

MR O'DONNELL: Yes. But in the debate they make these remarks, which indicate to my way of thinking that

they are definitely of the view that something should be done, and I say that it never has been done, and it is time to do it.

THE CHAIRMAN: Yes; because, you see, the Prime Minister in that debate went away beyond that, and said---

MR O'DONNELL: He was just reviewing what would have happened---

THE CHAIRMAN: Surely he did not expect the Co-operation Act was going to cure all that.

MR O'DONNELL: No, maybe not; but I am simply saying that he was there commenting on the situation in which this road found itself.

THE CHAIRMAN: I was just trying to find out from you what, if anything, had been done. Nothing was done until---

MR O'DONNELL: Nothing done along the lines we are asking for at the present time; and what was done in 1937---

THE CHAIRMAN: You are coming to that?

MR O'DONNELL: What was done in 1937 I am coming to, yes. And what was done then does not adjust what we are asking should be adjusted now.

Now, getting back to what I intended to say, that at this time this matter interests really the owner of the road and the railway as such, I said that our management and our directors had given this very serious consideration, and felt that if these claims of \$1,533 million were to be compromised or adjusted at a figure of \$1,060 million, that would be a reasonable enough thing to do, and if that be done, then they think that the Canadian National capital revision will be satisfactorily adjusted.

THE CHAIRMAN: Where will that bring your fixed

charges to?

MR O'DONNELL: Well, I am also coming to that, my lord. As I suggest---

COMMISSIONER ANGUS: We have had several comparisons to bankruptcies and reorganizations and so on. I imagine your items B and C from this table would have no counterpart in proceedings of that sort, would they? I mean, does an angel ever come forward in bankruptcy proceedings and put up a hundred million dollars without looking for any return?

MR O'DONNELL: Items B and C? Well, the purchaser of the bankrupt assets at that point would have discounted his purchase price to that extent if he had been acquiring the properties. That is all we are saying there.

COMMISSIONER ANGUS: But the purchase price on that hypothesis would be zero.

MR O'DONNELL: Well, whatever the purchase price might be. If there had been a bankruptcy and these interest-bearing obligations had been either wiped out or fixed at a very low figure, on our evidence in any event, then the purchaser of those properties would have had, to operate them as an entity, to know that he would have to spend these items at least.

COMMISSIONER ANGUS: Yes, but there would be no purchaser if he had to put up \$390 million to get something that had no earning ability.

MR O'DONNELL: That is true, there would have been no purchaser, and that is what I am saying, that the Canadian National Railway Company as a company, if it had been dealing at arm's length with the bankrupt roads or the receiver of the bankrupt roads, would never have paid anything like the \$2,286 million that they were carried on

to the balance sheet for. That is all I am saying. There would have been an adjustment at that point, and the prospective purchaser would have realized that had he had to operate them as an entity subsequently he would have had to spend these moneys, and he would have taken that into account. But what happened here was that the properties were taken into the new company without any such adjustment, and the new operator had to find these additional moneys to co-ordinate and then to stand the loss on the operations; and that is what we say the company should not have had foisted on to it and been saddled with, and what should be adjusted at this time.

COMMISSIONER INNIS: You want \$473 million taken off?

MR O'DONNELL: How much?

COMMISSIONER INNIS: \$473 million.

MR O'DONNELL: Yes, roughly, on our computation, yes. We have a claim for \$1,533 million, and if you fix it up so that we get relief to the extent of \$1,060 million, against the issue to you of equity stock commensurate in amount, then we consider that we can operate with reasonable hope of not having deficits on the average.

THE CHAIRMAN: Well, is that equity stock that you propose to issue of any real effect, when the Government is already the holder of everything, all the stock?

MR O'DONNELL: Well, it represents a record of the transaction.

THE CHAIRMAN: A record, yes.

MR O'DONNELL: Yes, and that is what our friends have said, "Oh, we must not lose sight of these things, we have got to keep them out in the open always." It records what happens, and there it is. I agree that the owner owns the entire apple, and whether you cut it into a hundred

parts or anything else it is still the same thing.

THE CHAIRMAN: Or whether they see fit to have more equity stock issued to themselves or not, I suppose, is their concern.

MR O'DONNELL: That is correct. If they accept our proposal, which is that that I am about to explain, then they will have more equity stock shown on the balance sheet than they have at the present time. We will have less liabilities in the way of interest debt.

THE CHAIRMAN: Will it be of any advantage to them to increase their holdings of equity stock?

MR O'DONNELL: I did not catch that.

THE CHAIRMAN: I say would it be of any advantage to the owner, that is, the Government---

MR O'DONNELL: Well, we say it won't affect the owner.

THE CHAIRMAN: I mean, to increase the equity stock which it already holds?

MR O'DONNELL: No, because the balance sheet items are still there, the equity stock balanced off against the other side of the balance sheet. That is why we say, as to these securities which they have in their hands at the present time, it does not cost them anything to exchange those interest-bearing securities for---

THE CHAIRMAN: Why change them into anything, as long as you---

MR O'DONNELL: Because it will grant the railway relief of this interest, that is all.

THE CHAIRMAN: Can't they grant you the relief you ask for---

MR O'DONNELL: Well, there may be other ways of doing that.

THE CHAIRMAN: ---without issuing this more equity

stock to themselves?

MR O'DONNELL: There may be other ways of doing it, my lord; but all I am saying is that our board of directors and our executive have considered that this is the proper way. I am not saying there are not other ways.

THE CHAIRMAN: I was just wondering whether what I might call this fiction of issuing more equity stock to themselves was of any value or a necessary part of the transaction.

MR O'DONNELL: Well, it is the balance sheet item that has to appear. In practical outcome I agree with your lordship that it does not affect the owner's position at all. That is what we say.

THE CHAIRMAN: Well, anyhow, we know what you want.

MR O'DONNELL: That is what we say.

I am simply saying, then, that if we can get what we suggest we would settle for, \$1,060 million, which, as Dr. Innis says, is about four hundred and some odd millions less than the claim as we compute it.

Now, the mechanics for carrying out that settlement we discussed, I think, here once before in a brief way, in volume 114 at page 20776 and following. The mechanics for carrying out the settlement are relatively simple, in our proposal. First, the Government should return to the railways the \$760 million of interest-bearing obligations, which are really promissory notes of the railway which it holds. The Government holds those at the present time. The Government should return those to us, and at the same time the Government should give the railway an acknowledgment of indebtedness of \$300 million, or we might liken it to another promissory note, its own promissory note, for \$300 million. That is the way we

suggest the Government's end of the deal should be carried out. They release or turn over to us promissory notes, really, which they hold of ours, \$760 million worth. They have them in their possession. Those are the interest-bearing securities which we have got to find interest for or which will be charged against us if we do not have the interest. And they will undertake to set up an indebtedness of \$300 million. That is how we suggest the \$1,060 million be found.

THE CHAIRMAN: That would entail, in so far as figures have any real meaning, two concessions by the Government. They hand you over \$760 million---

MR O'DONNELL: And we hand them back something.

THE CHAIRMAN: And they hand you in addition to that \$300 million.

MR O'DONNELL: They set up a credit that we can draw on as we see fit, and in the interval we draw the interest on it if we do not get it from them. Now, that is the Government's end of the deal. The Government would surrender these interest-bearing obligations that they presently have, \$760 million, and would set up a credit of \$300 million for us.

Now, as to the railway, the second party to the transaction, the railway on its part would forego in round figures about half a billion dollars and would issue stock to the extent of the total of the promissory notes, so to speak, involved, the \$1,060 million. Now, in this way, as far as we are concerned, the compromise settlement or the adjustment or the relief accorded could be very easily carried out.

THE CHAIRMAN: Don't you see, again, that you are, it seems to me, trying to split the one party in two?

MR O'DONNELL: No, I am not.

THE CHAIRMAN: Because the Government is the only owner of all this, all the stock and everything else.

MR O'DONNELL: That is true, but as far as the balance sheet is concerned -- the Government owns the whole thing, there is no question of that.

THE CHAIRMAN: Taking it all in as a recommendation from you---

MR O'DONNELL: That is right. In other words, they have presently these pieces of paper that represent a charge, interest-bearing claim that the Canadian National is asked to pay.

THE CHAIRMAN: You want that to disappear.

MR O'DONNELL: We want that to disappear, and we suggest that can very easily disappear by their surrendering those to us against the issue by us of stock which will represent equity on the balance sheet. Against the funded debt, \$760 million, they surrender that and get other paper that represents equity, and the balance sheet adjustment is made accordingly. Now, we, on the other hand, will forego the claim which we think we have a right to ask for settlement in full of; that is, we say we have a claim for \$1,533 million. We will compromise it if they do these things for \$1,060 million.

THE CHAIRMAN: We will take a few minutes now.

(Recess)

(Page 23920 follows)

After Recess:

MR. O'DONNELL: May it please the Commission, for the purpose of understanding the method or means of providing settlement or relief for payment of \$1,060,000, and the division of that total amount into two items of \$760,000,000 and \$300,000,000, which have just been mentioned, it might be well to refer here to the evidence given on the subject by Mr. Fairweather and Mr. Cooper. In volume 111, page 20370, Mr. Fairweather said:

".... we did not take that \$300 million into account specifically for those purposes. We took the whole of the \$1,060 million, the \$760 million plus the \$300 million. That is the sum total of the relief we were asking for, and I cannot segregate out of it so much for this and so much for that. We took the whole field of our managerial activity as we saw it in the future against the perspective of the past, and, having measured as far as we could by our judgment the discernible trends, we said we need \$1,060 million relief of fixed charges. That is the only answer I can possibly give to that question."

THE CHAIRMAN: Pardon me, but you say \$1,060 million relief?

MR. O'DONNELL: Yes, my lord. We have a claim for \$1,533 millions; that is our suggestion.

THE CHAIRMAN: You put it that way?

MR. O'DONNELL: We put it that way, that we would take an adjustment which would provide relief of \$1,060 million of interest-bearing securities, or interest bearing debt. To come back to what Mr. Fairweather said on that page, in part he says:

"...there is no division between the \$300 millions -- I would like to make this perfectly clear --

"Q. I do not suggest there was.

A. There is no division between it and the \$760 million. It is simply that in total we wanted relief enough to keep us out of a deficit position, and we said \$760 million may be obtained here and another \$300 million is necessary to add up to the total of what we consider is necessary to accomplish the purpose we are after. "

It might be well to emphasize at this point that the adjustment of the capital structure as proposed by the Canadian National is a single proposal for an over-all settlement. It is not a piece-meal proposition of picking and choosing parts of the plan; it is one single proposal. That was made clear by Mr. Gordon. It is not a matter of picking and choosing parts as was suggested by Mr. Norman. They are not alternative plans or separate plans. It is all a part of one plan. Mr. Fairweather indicated at page 20073, of volume 109, that the mechanics of a possible settlement were easier at this time than they had been previously.

".....in that the government today has in its hands this \$760 million of interest-bearing obligations."

And again:

"...and as to the balance of it, the difficulty which previously existed of handling the debt which was in the hands of the public is solved on a reasonable compromise basis by this proposal."

THE CHAIRMAN: When you say the situation is more easily adjusted today than previously, are you referring to 1937 as previously?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Has this \$760 million of notes come into existence since 1937?

MR. O'DONNELL: No. They are the succession of the \$804 million which has been running since 1923. Some of them have been refunded.

THE CHAIRMAN: I thought you said it is easier now to settle than previously?

MR. O'DONNELL: Yes.

THE CHAIRMAN: On account of the existing situation.

MR. O'DONNELL: On account of the government having that amount in its hands, in its possession.

THE CHAIRMAN: They had been where?

MR. O'DONNELL: They were out in the hands of the public. They have been acquired.

THE CHAIRMAN: Have they been acquired since 1937, or were they not already acquired then?

MR. O'DONNELL: During the war, most of them.

THE CHAIRMAN: Oh yes, that is so.

MR. O'DONNELL: Previously there was such a tremendous amount in the hands of the public they could not deal with the settlement.

THE CHAIRMAN: In 1937 the situation was different.

MR. O'DONNELL: Yes. That is what Mr. Fairweather says:

"... in that the government today has in its hands this \$760 million of interest-bearing obligations."

THE CHAIRMAN: They were repatriated?

MR. O'DONNELL: Yes, principally. Then Mr. Fairweather goes on:

"And as to the balance of it, the difficulty which previously existed of handling the debt which was in the hands of the public is solved on a reasonable compromise basis by this proposal."

THE CHAIRMAN: Tell me again what was the amount of this repatriation?

MR. O'DONNELL: The amount that the government has in its hands at the present time is \$760 million.

THE CHAIRMAN: All right.

MR. O'DONNELL: As to this \$760 million, my lord and members of the Commission, the Commission will recall that the main brief, pages 63 and 64, points out that such a settlement will not cost the government anything. I read from Exhibit #214 at page 63, as follows:

"The adjustment proposed --"

That is as to the \$760 million.

"-- would not cost the government any money. As the sole shareholder any gain or loss is for account of the government. In the final analysis the fixed interest rates is meaningless since there is a deficiency ^{if} it must be provided by government, and likewise government will take any surplus there may be after payment of interest on the .publicly held debt."

THE CHAIRMAN: I rather like to hear you talking in that way, Mr. O'Donnell.

MR. O'DONNELL: Yes, I may have been putting it in a different way, but I am saying the same thing. I am just trying to explain where they could get the \$1,060 million, first, to the extent of \$760 million by these interest-bearing securities which are presently in the hands of the government, and it will not cost them anything as is said at this page. Then it goes on:

"It is more a matter of removing from railway to public accounts the extent to which commercial considerations have been subordinated to considerations of broad national policy."

The following exchange of questions and answers between Mr. Frawley and Mr. Cooper at pages 18860 and 18861, serve to explain the proposal and the amount of \$300 million

involved therewith:

"Q. What would it represent? In other words what is the principle behind it? Why do you think that the government should acknowledge any indebtedness to you in the sum of \$300 million? "

Mr. Cooper answered in part:

"A...it is a method which the president has advanced whereby interest on the funded debt held by the public --

Q. By the public, yes.

A. Might be reduced as far as the cost in interest to the railway is concerned. We have \$584 million of fixed charge debt in hands of the public. We think that is too high; we think that the railway cannot support that amount of debt; but we cannot touch those securities. So the introduction of this \$300 million whereby the government would pay to us each year \$9 million, the \$9 million would have the effect of reducing the annual interest on the debts held by the public, that is to say, if the interest on the debt held by the public is \$23 million and we get \$9 million from the government, then our interest is \$14 million."

And again Mr. Cooper said, in volume 100, page 18711 :

"THE WITNESS: If we were tied down to the \$584,000,000, because that is held in the public, and we said we cannot touch that, we must go on with it on our shoulders as a burden, we would say it is only a partial adjustment. But the introduction of the \$300,000,000 figure is a method by which we can get around the difficulty that always existed in any attempt to adjust the capital structure of the railway.

The Chairman: You show here how you would reduce it?

Mr. O'Donnell: In so far as the debt in the hands

"of the public is concerned."

As I have said, the proposal to deal with this excessive capital debt burden is one single proposal. In short, the proposal amounts to an attempt to eliminate from the balance sheet and the income account excessive capital burden charges which should never have been shown or incorporated in the balance sheet or the income account. In its simplest form, that is the problem, and the only problem to eliminate from the balance sheet and the income account those items which should never have been shown.

As we have said, it is a matter strictly between the railway and the government. No one else is concerned with this "internal housekeeping" matter which will permit the accounts of the Canadian National to be simplified and give a truer picture to the public annually of its operating results.

Had the matter relating to the amalgamated bankrupt railways been adjusted at or prior to consolidation, by recourse to bankruptcy proceedings as other railways in similar situations experienced, the problem would in large measure, in so far as those items are concerned, have been settled or never have arisen.

In this connection, the Commission will remember the recommendation of the Drayton Acworth Commission, recommendation 28, which I have previously read. What I have said is in strict conformity, in my respectful view, with what the Commission recommended.

Recommendation 28 reads as follows:

"We recommend that the government assume responsibility to the Dominion Railway Company for the interest on the existing securities of the transferred companies."

If that had been done, this part of the problem would not

have been in the picture during the years since 1923. The
debt
remainder of the capital burden complained of,
which has been computed in terms of negative capital, constitutes further and constant fixed charges in addition to those created by the bonded indebtedness. The negative capital items should likewise have been adjusted before they were imposed upon the system. The system should never have been called upon to bear any of these burdens. I say that that proposal is in strict conformity with the recommendation of the Duff Commission.

Paragraph 61 of the Duff Commission^{report}, referring evidently to these five railways that are listed on this tabulation under Item E, stated:

"...but the Commission believes that it would have been better had the government assumed this burden directly and thus avoided saddling the railways with capital charges and operating expenses resulting from the purchase of railways based solely on a public policy."

(Page 23928 follows)

THE CHAIRMAN: Now, did that Duff recommendation go further than the legislation of 1937 went?

MR. O'DONNELL: Yes, the Duff Commission does go further. It says this should have been adjusted. I say the legislation of 1937 did not adjust these things at all and it should have been adjusted. Then the Duff Commission went on to say that the time was not opportune at that time. They acknowledged the problem was there. I will have something to say as to other recommendations of the Duff Commission later. They acknowledged it was there.

I say our proposal as to \$300 million which is to take care of the negative capital items in part along with these others, is in strict conformity with that paragraph 61. I say that as to the other part of the problem whereby the \$760 million is provided, that is in strict conformity with the recommendations of the Drayton-Acworth Commission. So that our proposal is not anything that has not been founded on the recommendations and study by previous commissions: it is in strict conformity with them. The only thing is, we say this adjustment has been delayed far too long, and that we should face the problem now and deal with it and do what both these Commissions said should have been done.

COMMISSIONER INNIS: I was rather struck by the fact that your equity capital would amount to about \$760 million. The C.P.R. equity is about \$472 million.

MR. O'DONNELL: In what way, Dr. Innis?

COMMISSIONER INNIS: It seems to me that you are suddenly being put into a much more manoeuvrable position. I know you don't want to bring the Canadian

Pacific into this picture.

MR. O'DONNELL: No.

COMMISSIONER INIIS: But it does seem comparable. Now, I admit one cannot look into the question of fixed charges and so on, and this is something which strikes one rather immediately.

MR. O'DONNELL: Well, as I say, our people have undoubtedly given that consideration from every possible angle; and when one bears in mind the fact of the operating difficulties and characteristics that Mr. Fairweather spoke of, where there is such a tremendous difference between the two properties, their considered view is that that is not out of line. I am going to come to the evidence on that point.

So much for the proposal as we put it forth. Now, I turn to the next point of argument which is:-

VII. EFFECT OF PROPOSAL AND RESULTS EXPECTED

Now, what does the proposal of the Canadian National look like, I might ask, when reduced to paper? What results can ^{it} be expected to produce for the Canadian National?

The evidence of Mr. Gordon, Mr. Cooper and Mr. Fairweather is clear as to the expectations in this connection.

Mr. Gordon said (Vol. 98, p. 18388):-

"These measures, if put into effect, should enable Canadian National, on the average, to meet its fixed charges, including interest on funded debt."

Before proceeding to discuss the results which our proposal can be expected to produce, I would like to draw attention to the evidence of Mr. Cooper in Vol. 100

page 18699-700 when cross-examined by Mr. Covert with respect to the effect that the earnings of the Canadian National Railways can justify only a very small amount of fixed charge debt. Mr. Cooper's evidence reads:-

"In fixing the amount of fixed charge debt for any enterprise there must be regard for the ability to service that debt. If you were to submit a recapitalization proposal to the Interstate Commerce Commission, they would want to determine the amount of net earnings that would be available under all conditions. Having determined that amount, they would fix the amount of permissible fixed charge debt. Now, if that is fixed, only the balance, irrespective of the proportion, can take the form of equity capital. So the amount of equity capital is determined by the protection that net earnings afford to the fixed charge debt. It is not to be determined by some arbitrary proportion such as sixty and forty or anything of that sort. In our case we say that the ordinary relationship between the two should not be used.

"Q. Then do I understand you, Mr. Cooper? You say that in the case of the Canadian National the ordinary relationship should not be used?

"A. I do.

"Q. And the reason for that is?

"A. For example in 1949 we earned \$4 million which was available for the payment of interest. Now, how much fixed charge debt would that justify?

"A very small amount."

Mr. Cooper also stated at page 18701 (Vol. 100):-

"....If it were not for the Government ownership of the Canadian National all the capital would be in the form of equity capital, because the earning record of the company would not justify any fixed charge debt."

On this point the Commission will also remember the considered view of the Canadian National as presented by Mr. Gordon at page 18379 of Vol. 98 that "to show results of operation which would meet commercial tests, the amount of interest-bearing capital which may be included in a restatement of the capital structure should be of relatively small proportions, in contrast to the present interest-bearing capitalization of \$1,344 million."

Now, as to what surpluses are to be expected. This is what the people who are in a position to know, say. Mr. Cooper at Vol. 100, pp. 18652-53 :-

"In my evidence at page 18582, I stated that the average annual deficit of the Canadian National Railway System in the 27-year period 1923-49 had been \$20,808,914; I also stated at page 18578 that the adoption of depreciation accounting for Canadian Lines rolling stock had increased our expenses. If we had had depreciation accounting throughout the 27-year period the average annual deficit would have been \$25,977,989. I also stated at page 18579 that there is nothing in the results shown in Table No. 4 in respect of the Newfoundland Railway. If we add

"\$4 million per annum, the average annual deficit would be \$29,977,989. That is to say, taking the record of the Company since amalgamation and adjusting to present day conditions with respect to depreciation and the Newfoundland Railway, our average annual deficit would be in close approximation to the relief indicated as necessary. On this basis nothing is available for a return on equity capital nor does it give the railway anything to 'come and go on'".

I then asked Mr. Cooper to draw a consolidated balance sheet which would show, applied to the 1948 results, the situation as it would be if the relief requested were to be put into effect. Mr. Cooper prepared such a balance sheet and it was produced as Exhibit 245. It illustrates very graphically the result of the readjustment now proposed (Vol. 100, page 18654). It shows the published results for 1948, the adjustments which have been suggested, and what the position would be as and when the adjustments are made.

Mr. Cooper then explained in detail (pages 18654-55) the adjustment proposed, as set out in Exhibit 245.

Mr. Cooper also explained the proposals from the point of view of the income statement and produced Exhibit 246, which applied the proposed adjustments to the 1949 results (page 18656).

Between pages 18656 and 18661 Mr. Cooper explained the details of the adjustment as reflected in the income results, and said, at the bottom of page 18657, by way of summarizing the situation:

"Then, if interest on Government loans were cancelled, there would be a credit or a relief to the extent of \$21,798,000. If we take credit also for the 3% on the \$300 million, the results would be further improved by \$9 million. On those assumptions, instead of a deficit in 1942 of \$42 million, we would have had a surplus of \$13,698,000."

With respect to the suggestions which were made on behalf of the Canadian Pacific, that the proposed adjustment would result in substantial surpluses to the Canadian National, the following evidence of Mr. Cooper is material: In volume 99, at page 18577, Mr. Cooper stated that the annual deficits experienced since 1923 were approximately \$20 million. At page 18578 Mr. Cooper stated that pension costs have risen from \$652,974 in 1923----

THE CHAIRMAN: What costs?

MR O'DONNELL: Pension costs, my lord, have risen from \$652,974 in 1923 to \$11,562,547 in 1949, an increase of approximately \$11 million per annum.

At page 18578-9 Mr. Cooper stated that adoption of depreciation accounting for Canadian lines rolling stock has increased the C.N.R. expenses, and that depreciation of this nature in 1949 which was not accrued prior to 1941 amounted to \$17,361,000.

At page 18518 Mr. Cooper stated that the entrusting of the Newfoundland Railway increased their operating losses by \$4 million.

Now, with all those things in mind, he was of the view that even on the adjusted basis as proposed the

Canadian National could not expect large surpluses in the future.

In volume 100, at page 18676, while being cross-examined by Mr. Covert, he said in part:

" . . . adjusting the record of the Company since amalgamation to present day conditions with respect to depreciation and Newfoundland, our average deficit has been \$29,977,989; so that the relief, if given, would, on the record as adjusted . . . just about make the break-even point."

COMMISSIONER INNIS: Have you the variations between the annual earnings, the highest and the lowest?

MR O'DONNELL: They are set out, Dr. Innis, in the brief, in those tables. If you would look at Tables 1, 2, 3, 4, right through, you see there the gross earnings, the net revenues and the whole thing right from the year 1923 through to 1948.

THE CHAIRMAN: That is in the brief, is it?

MR O'DONNELL: Yes, it is in the main brief, my lord. Also you will see there on Table 4-A results of operations, where the computation has been made excluding the depression years and excluding the war years, and it has been made on the basis of the entire period 1923-1948. We also gave the figures in evidence for the year 1949 as well, so that you have the entire history of operations and results set out on those tabulations which are in the brief, and you have them computed on Table A in brackets, three periods, for instance, 1923-1931, 1932-1939, 1940-1948, and then you have them averaged for the different years at the bottom of that Table 4.

Now, Mr. Cooper, answering my friend Mr. Covert in cross-examination, said at page 18675:

"A. . . . The relief of Government interest

plus the \$9 million would be \$30,798,000.

Q. Now, would you explain that to me?

A. Well, the Government interest in 1949 was \$21,798,000.

Q. Yes.

A. If you increased that by \$9 million, then the relief is \$30,798,000.

Q. Yes.

A. And that is the relief which these proposals, if adopted, would give to the Railway. Now, I then go on to show that based on the record of the past adjusted to present day conditions with respect to depreciation and the Newfoundland Railway, that the deficit from 1923 to 1949 would have averaged \$29,977,989, or within less than a million dollars of the relief itself. And of course I have not brought in everything that I could have brought in to build the deficit up. I could have added the Temiscouata Railway for example. I am sure the Newfoundland Railway will exceed \$4 million."

So at that point the evidence is that, on the computation of the entire amount of relief asked for being given, it would be within less than half a million dollars of the relief itself.

Now, in reply to Dr. Angus' suggestion:

" . . . that on the average you are contemplating surplus earnings equal to zero?"

At volume 102, page 18943-4, Mr. Cooper said:

"A. On the basis of 1949 we would have surplus earnings of \$13 million. Advance it one year to 1950; in 1950, which is you might say the closest we can get to present-day conditions, we have furnished to the Government our operating budget for the year 1950. It

shows a deficit for the year of \$44 million. Against that should be applied the amount of additional revenue which we expect to receive as the result of the recent order of the Board of Transport Commissioners increasing the 8 per cent to 16 per cent. That figure is around \$11 million, so that our best forecast as of today is for a deficit of \$33 million. If the proposals advanced by the President were approved and made effective as of January 1, 1950, we would finish up with a surplus of \$2 million," -- Later, I might interject here, Mr. Cooper corrected that, in volume 103 at page 19068, to say that instead of a surplus of \$2 million the C.N.R. would have a deficit of \$1,400,000 in 1950. To go on with the quotation from page 18944:

" . . . we would finish up with a surplus of \$2 million, and that is without any regard for any additional wages which may be granted as the result of negotiations which are now in progress, and it is on the basis that traffic volume will continue as it was forecast at the date the estimate was made.

I called attention yesterday to the fact that the \$13 million would disappear if we had a reduction in traffic volume of $2\frac{1}{2}$ per cent, and that at the present time -- that is, January and February -- our traffic volume is down 8 per cent as compared with a year ago.

So, taking that as the closest estimation that we can make of the situation as it is in 1950, as adjusted by these proposals, we just about break even.

Q. Well, does that amount to saying that I am right in putting the interpretation which I in reading this and hearing from Mr. Gordon put on it, that what

is contemplated is a surplus in some years, but on the average breaking even?

A. I think that is a fair interpretation."

THE CHAIRMAN: Do you think you are going far enough, then?

MR O'DONNELL: Well, we have made a point of saying that we think the requests are restrained and conservative, and that we have not asked for all we could have asked for.

THE CHAIRMAN: Do you not apprehend the possibility of having to come back in another year and asking for something more to be done?

MR O'DONNELL: Well, all I can go by, my lord, is the proposal as put forward with that assertion, that if these proposals be recommended and be made effective, on the average the result that has been mentioned is what is to be expected.

THE CHAIRMAN: That is, to break even.

MR O'DONNELL: To break even -- a deficit in some years, a surplus in other years, but on the average break even.

COMMISSIONER INNIS: Amazed at your moderation?

MR O'DONNELL: Well, maybe we are. On the other hand, one step enough.

THE CHAIRMAN: One step enough -- that is just the point. I thought this was to be something in the nature of a final settlement.

MR O'DONNELL: Well, as far as we are concerned at this point---

THE CHAIRMAN: If it is only another---

MR O'DONNELL: Well, I said that rather facetiously to Dr. Angus; possibly I should have been more serious about it. But I am simply saying that the proposal as formulated

and put before the Commission is that if it be accepted in toto, the results to be expected are those concerning which I have just read some of the evidence.

COMMISSIONER ANGUS: In these estimates, Mr. O'Donnell, there were times when Mr. Cooper was more optimistic. Has there been a perfectly consistent treatment of the hypothesis that the imbalance between costs and freight rates would be rectified? I mean, don't they sometimes assume that that imbalance is still there?

MR O'DONNELL: No.

COMMISSIONER ANGUS: And sometimes assume---

MR O'DONNELL: On my understanding, Dr. Angus, the proposal is predicated on the assumption that the imbalance will be rectified. May I just draw the attention of the Commission to the words of the proposal; I will give the Commission the reference in a moment. The words of the proposal are these:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital. However, in view of the practical difficulty in the way of converting the interest-bearing capital in the hands of the public into equity capital at this time; and having regard to the potential earnings of the Canadian National System, which are considerable and may in some degree offset the adverse factors here considered; and on the assumption that the present imbalance which exists between railway rates and railway costs will be removed by adequate rate increases, I submit the following as an appropriate adjustment:"

And then he submits the adjustment.

COMMISSIONER ANGUS: I had that clearly in mind.

What I was thinking of was this, that in the evidence that you read a few minutes ago it was made a point of moderation, as it were, that this was assuming that there would be no further increase in wages. Now, if there were a further increase in wages that would be creating an imbalance or increasing an imbalance, and bringing in that suggestion seemed to me to be varying your initial hypothesis.

MR O'DONNELL: I do not think that our initial hypothesis is varied at all. It is predicated throughout on there being no imbalance between rates and costs. But there is a time lag -- we can agree on that -- there is a time lag; we cannot eliminate that. We are hopeful that in the future it may be a shorter period than it has been, and I think the last two or three applications---

COMMISSIONER ANGUS: The year affected by such a time lag would be atypical, wouldn't it? It would be exceptional?

MR O'DONNELL: Yes, because until 1946 for twenty years there had been no rate increases, no general increases, and after the First World War there was a cycle of this. It started in 1917 and it ran along until, as far as rate increases or rate decreases are concerned, 1922. First we had the 15% Case, the 25% Case, the 40% Case, increase cases. Then there was the 1921 reduction and the 1922 reduction. Then there was a general freight rate inquiry. But there was that cycle, and after this war there is the same cycle, which I think is running out now. We have had 40 per cent, a little better than 40 per cent increase since 1946, and these adjustments are, I think, predicated, as they are said to be, on the fact that the imbalance will be removed. Now, there is the time lag -- one cannot help that -- but generally speaking

that has been taken into account and is considered, and I think our computations have been consistent in treating the matter of the imbalance.

COMMISSIONER ANGUS: At various points in the evidence, though, there were suggestions that a surplus might be built up and used for certain purposes. Now, how could it be built up in years that on average are breaking even?

MR O'DONNELL: That is getting back to that stabilization fund, and that we withdrew, as you will remember.

COMMISSIONER ANGUS: Yes, but did you withdraw the estimate on which it was based?

MR O'DONNELL: We withdrew the entire suggestion, by reason of the fact that it does not come into play; it is covered by the law. If there are surpluses we have to take them to our owner, or our owner is entitled to them; if there are deficits our owner gets the bill -- there is no doubt about that -- but when we said that there might be surpluses in some years it was on the same hypothesis that I am putting today, that if there are surpluses, well, it will be only on the rates that have been fixed by the Board, and if they are fixed by the Board and we can operate under those and have a little money, that is all to the good. If we cannot, we will have the deficit as before. But I do not think that there is any inconsistency in the treatment of the estimates.

COMMISSIONER INNIS: That seems a very serious proposition. If you look over your balance sheets, there is a tremendous variation between good and bad years.

MR O'DONNELL: No doubt about that; and there is a tremendous variation in the returns too. Yes, there is no doubt about that, and we cannot help that. That affects

everybody in the transportation business, and it affects us more than anybody else in the transportation business, because we have these characteristics that we say place us in an inferior position, owing to the considerably lower traffic density that we have and these other adverse operating difficulties that we have to put up with.

THE CHAIRMAN: We will adjourn now.

---The Commission adjourned at 4:47 p.m., to meet again at 10:30 a.m. on Thursday, May 25, 1950.

A.R.

Canada
ROYAL COMMISSION
ON
TRANSPORTATION

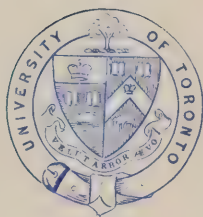
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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, May 25, 1950

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
THURSDAY, May 25, 1950

THE HONOURABLE W.F.A.TURGEON, K.C. LL.D. - CHAIRMAN
HAROLD ADAMS INNIS - COMMISSIONER
HENRY FORBES ANGUS - COMMISSIONER

- - - - -
G. R. Hunter,
Secretary.
- - -

COUNSEL APPEARING:

| | | |
|------------------------|---|--|
| F. M. Covert, K.C. | } | Royal Commission on Trans - portation |
| G. C. Desmarais, K.C. | | |
| H. E. O'Donnell, K.C. | } | Canadian National Railways |
| N. J. MacMillan, | | |
| H. C. Friel, K.C. | | |
| C.F.H.Carson, K.C. | } | Canadian Pacific Railway |
| F.C.S.Evans, K.C. | | |
| I.D.Sinclair, | | |
| K.D.M.Spence | | |
| M. A. MacPherson, K.C. |) | Province of Saskatchewan |
| J. J. Frawley, K.C. |) | Province of Alberta |
| C. D. Shepard. |) | Province of Manitoba. |

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Ottawa, Ontario,

Thursday, May 25, 1950

MORNING SESSION

ARGUMENT BY MR. O'DONNELL (Cont'd)

THE CHAIRMAN: All right, Mr. O'Donnell.

MR. O'DONNELL: May it please the Commission, yesterday there was some reference made to the Capital Revision Act. Your lordship asked me about it and I answered possibly not as fully and completely as I should have. I should like to refer your lordship and the Commission to a fairly complete statement of the Capital Revision Act and what it did, which will be found in the brief of the Canadian National Railways, Exhibit 214, at pages 26, 27 and 28. That gives a fairly complete story. I think yesterday I had just got to the point where --

THE CHAIRMAN: Pardon me, the pages to which you have referred deal with the Act?

MR. O'DONNELL: Yes.

THE CHAIRMAN: Is the Act itself there?

MR. O'DONNELL: I think it is. If it is not I will be glad to get a copy. My friend Mr. Friel says it is not but I will be glad to get a pamphlet copy. I was saying we were reviewing what the effect would be if the proposals were put into effect as put forward by the Canadian National Railways. I think I had reviewed some of the evidence concerning the expectation as to surpluses which might be expected, and that we felt they would not be substantial, and that if relief were accorded -- I think I referred to Mr. Cooper's statement that we would about expect to break even on the average. Some years we might have a surplus, and some years we might have a deficit. I should like to take up where we left

off yesterday and I would refer --

THE CHAIRMAN: Pardon me a moment. I will just tell you now so you will be prepared later. This Act is called an Act to provide for the cancellation of capital stocks and certain indebtedness.

MR. O'DONNELL: Yes.

THE CHAIRMAN: All right, go on.

MR. O'DONNELL: I should like to refer to the evidence of Mr. Cooper in Volume 101, page 18784, where he said:

"I showed you yesterday that for the year 1949 with all the additional revenues assumed to have been received, with these adjustments made, that our net income would be a matter of \$13 million. Now, that surplus would disappear if our traffic volume were to be reduced by 2½%."

He went on to say:

"I said therefore that even on this basis there is really nothing left for additions and betterments. I don't think on that basis that we have yet approached comparability with the Canadian Pacific in results."

At page 18960 he also said, "I feel that the possibility" --

THE CHAIRMAN: Does all this mean, Mr. O'Donnell, that what you are asking for is moderate, and that in the future you may be in a condition of uncertainty again?

MR. O'DONNELL: The statement is if we get these adjustments that on the average we will be able to meet our fixed charges and some years have a surplus, and possibly some years have a deficit. On the average we will be able to meet our fixed charges. That is the proposal on the best assessment that our officers and

the Board of Directors can make. Mr. Cooper said:

" . . . I feel that the possibility of surplus earnings under this adjusted set-up is not very large. I think we should do very well indeed if we broke even, one year with another."

COMMISSIONER ANGUS: Did not Mr. Cooper take a rather more optimistic view when he pressed the case for the Canadian National Railways paying income tax on that surplus?

MR. O'DONNELL: So far as income tax is concerned, he said that if you wanted to take that into consideration as an item for comparison that could be taken in.

COMMISSIONER ANGUS: Income tax on something the average of which is zero is not very big.

MR. O'DONNELL: That may be. However, at this point I am endeavouring to review the evidence as he put it before the Commission.

COMMISSIONER ANGUS: This was evidence. I wondered if it was quite consistent in spirit with the earlier evidence.

MR. O'DONNELL: In my respectful submission, Dr. Angus, the position throughout is consistent. You of course will undoubtedly read all the evidence and consider all the evidence. In Volume 102, at page 19033, Mr. Cooper agreed that "the Canadian National Railway would in years of high traffic volume have reasonably good surpluses" but questioned Mr. Evans' suggestion:

"You would have probably in some years surplus of the magnitude that you had during the war years?" Mr. Cooper said:

"In 1943 we earned $26\frac{1}{2}$ cents out of every dollar after we had paid our operating costs. In 1949 we earned $4\frac{1}{2}$ cents out of every dollar."

Then Mr. Cooper went on to say at page 19035:

"I cannot quite visualize ever a return to what we might call the prosperous years of war."

(Page 23949 follows)

And he said also:

"I like your optimism, Mr. Evans. I am probably a little more conservative than you are."

And Mr. Cooper's reasons, I submit, are readily understood when one considers the conditions which permitted the railways during the war. The relative prosperity which they enjoyed. In this connection, I would quote from exhibit 214 at page 33 as follows:

"The temporary prosperity which came to the Canadian National during the war followed a decade of depression. The greatest differences in its operations from the depression years were in the volume of traffic carried, the character of the traffic and the type of service performed. The volume of traffic was unprecedented. Higher rated traffic such as manufactured commodities and materials of war made up a very much greater portion of the gross than is normally the case. Cars were much more heavily loaded due to the maximum loading orders of the Transport Controller and the volume of goods being shipped by individual consignors. Further, the flow of war traffic permitted tonnage trains being moved over greater distances. Wartime control of trucking also reduced competition from this source. These characteristics permitted railway operation under the most favourable financial circumstances and accrued greatly increased operating revenues."

COMMISSIONER ANGUS: Is it implicit in that argument, Mr. O'Donnell, that in a low traffic year which was not an out and out depression year you do not think there should be a rate increase to compensate for the low traffic? That seems to be implicit there, does it not?

MR. O'DONNELL: I say to that that whatever the rates may be for the time being that the Canadian National with its disadvantage from the point of view of low traffic density is in an adverse position in so far as its chief competitor is concerned.

COMMISSIONER ANGUS: But its chief competitor would expect an increase in a low traffic year if it was not a depression year, would he not?

Mr. O'DONNELL: Well, that depends -

COMMISSIONER ANGUS: Is what you are saying consistent with your initial assumption that the imbalance between cost and freight rates would be redressed?

Mr. O'DONNELL: I would say this, that the imbalance is never going to be rectified to the dollar - that is certain. This is merely a statement I am reading and I have only read part of it and I would like to finish the rest. It is merely to explain why in the war years the revenues and the net were what they were and I respectfully submit that there is no inconsistency in our position at all and that all of those factors have been taken into consideration. The imbalance, in so far as it can be rectified, has been considered and the proposal is predicated on that fact.

Then, I go on with this statement from page 34 of the Submission:

"These characteristics permitted railway operation under the most favourable financial circumstances and accrued greatly increased operating revenues. Operating expenses, on the other hand, were relatively reduced by the maximum loading practices and slower schedules inaugurated for fuel conservation.

The results of these abnormal conditions are reflected in the earnings of the Canadian National for the war period. But it will be immediately apparent

that this period cannot be regarded as normal in the System's existence. Since the termination of hostilities, the character of the traffic has changed and the normal ratio between high and low priced commodities has been restored. Cars are no longer loaded to full capacity and the length of haul has been reduced."

That is the end of that quotation.

Mr. Cooper further said at page 19039:

"I do not believe for one minute that we may have a recurrence of the surplus earnings of the Canadian National which we enjoyed in the war years."

Now, Mr. Fairweather's evidence corroborated that of Mr. Gordon and Mr. Cooper to the effect that on the basis of the readjusted capital structure, the Canadian National cannot expect any extensive surplus in future years, that on the average it would break even.

Now, Mr. Fairweather, in Volume 109 at page 20072 said:

"I think that this adjustment is not going to make any feather bed for the Canadian National Railways. I am convinced that over the future, with the problems that are facing the railway industry and the Canadian National, these adjustments, together with such traffic as we will be able to handle, are not going to produce any more than the minimum required to perpetuate a reasonable capital structure. That is my opinion. There is no great amount of leeway over and above (a) the meeting on the average of your fixed charges and (b) protection against the pyramiding of your capital structure."

Mr. Fairweather's view of the Canadian National

proposal was again stated at page 20074:

"... on the average we should be, with prudent management, free from deficit financing and that we can maintain a reasonable stability of the capital structure of the Canadian National."

And again at page 20078 he said:

"I think on that score that no man knowing the full detail of the Canadian National problem can come to any other conclusion than that this readjustment of the capital structure is a conservative one - that is, it recognizes the principle that there should be some fixed interest-bearing capital. As I said, there were strong arguments in favour of saying that none of it should be, but there were strong arguments on the other side that said that it should be. I do not think that it would be desirable we should have access to capital funds and not have to earn a return on it. I think that necessity of earning a return is a good thing, and the only thing about it and the only way I would qualify it is, do not create a condition where under periods of average traffic we would have to be reporting deficits. Mr. Cooper, for instance, estimated that if all of the adjustments that are recommended in this brief were made in 1949, I think it was, we would only have \$13,000,000 available after we had paid our fixed charges, and I do not think that for a year of the traffic volume in 1949 that is a very great margin."

Now, the following exchange between Mr. Covert and Mr. Fairweather in Volume 110 at page 20175 and 20176 emphasizes the appraisal of the situation by the Canadian National:

"Q. All I want to know, Mr. Fairweather, is whether

you feel that the entire interest-bearing capital should be converted into equity capital, that is, to do a proper job, a real job, that should be done?

A. No, I do not think that is exactly what is stated."

And he quotes from the proposal. The proposal says:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital.

Q. The difficulty is that they are in the hands of the public?

A. Now, there is no doubt that if the Canadian National Railways was operating as a private concern that the amount of interest-bearing capital that it could bear with security and maintain a credit standing is very small and might, as is stated here, be zero.

The Chairman: Q. Be zero?

A. Yes, because the Canadian National Railways is a low-traffic density line. Our revenue per miles, notwithstanding the heavy industrialized sections I think it is about \$19,000 per mile and to operate a railway and give service under those conditions with that level of revenues creates a very severe problem indeed."

(23957 follows)

Mr. Fairweather's evidence negatives the possibility of the substantial surpluses suggested by the C.P.R., as is made clear by the following statement, which is at pages 20176-78. Mr. Fairweather said:

"We have very little cushion between a prosperous operation and one that is a deficit operation, quite apart from this matter of fixed charges. It is an inherent characteristic of the Canadian National Railways, and it is an inherent characteristic of any low-traffic density line. If we had, for instance, an average traffic density ten per cent higher than our present traffic density we could stand a very substantial amount of fixed charges with a degree of confidence, always supposing that we get this highway competition thing fixed up, and there was not further erosion of net from that quarter."

Again, he said:

" . . . I do not think any prudent man could say confidently that the Canadian National Railways might not at some time in the future, and within the foreseeable future, find itself in the position that it had no returns available to meet fixed charges."

Again:

" . . . the future holds interesting possibilities, and we hope that on the whole it will provide a cushion at some time in the future, but it is not there now, and in my opinion it is a very considerable time before it could arise."

Speaking further of the Canadian National proposal, Mr. Fairweather said, at page 20257, in part:

"What the Canadian National was trying to do was to

get out of the poorhouse, if you want to put it that way. . . . We wanted to have a target that we could reasonably shoot at under conditions similar to those that we had experienced in the past, modified by discernible trends, and that was our limited ambition and is our limited ambition."

And incidentally, at page 20283, Mr. Fairweather pointed the problem up when he said:

"We have already said that we are not asking to be made a rate base. We are asking to have our capital structure reduced."

And again, in volume 111, at page 20331, Mr. Fairweather said:

"Our submission for recapitalization of the Canadian National Railways had a very modest objective. That objective was, as I stated rather graphically before, to take us out of the poor-house; because by so doing, it was the judgment of our management that they could improve the managerial efficiency of the property. These other hypothetical and suppositional ideas as to what might happen when we get out of the poor-house I consider as largely irrelevant. From my dealings with the Canadian National Railways, and if my judgment as an analyst is of any value, I know that the recapitalization such as here contemplated, would not on the average produce large surpluses. If it produced on the average a little more than the zero figure that has been mentioned, I would not be surprised. But that it could produce large amounts beyond that, having regard to the trends that I have stated, and having regard to demands for additional capital which will have to be met, is contrary to my opinion; if it does, then I am a poor analyst.

" COMMISSIONER ANGUS : If the Canadian Pacific were given the level of rates which it was suggested were appropriate, you would then have large surpluses, would you not?

A. No. That is, if I understood your question to mean a level of rates such as would keep the Canadian Pacific in a healthy condition.

Q. If they were given a level of rates which enabled them to earn the rate of return that they have suggested is appropriate, on the rate base that they have suggested is appropriate, you would then have a large surplus, would you not?

A. No.

Q. Why not?

A. To explain that we would have to go back to my remarks previously about traffic density. The two properties are not identical. The great outstanding difference between them is in their traffic density. As I said, the operating ratio varies in proportion to the inverse square of the traffic density. Consequently when traffic density drops, the operating ratio goes up at a very sharp rate. There is approximately a ten per cent difference between the traffic density of the Canadian National and that of the Canadian Pacific Railway, the Canadian National being about ten per cent less dense than the Canadian Pacific. That has the inevitable effect that the Canadian Pacific has a cushion of net revenues which the Canadian National does not have. I expressed it previously by pointing out how barometrical the net earnings of the Canadian National were."

I think yesterday, Dr. Innis, you referred to the large swings or variations in the years, as between one

year and another, and I just make the comment here that Mr. Fairweather dealt with that very matter on two or three different occasions, particularly at this page I have just read, and also in volume 110, at page 20178; and I just make the further comment that the Canadian National proposal has taken all those pertinent matters into consideration and, using its best judgment, has come forward with the proposal which it thinks is a proper solution of its trouble.

Mr. Fairweather also stated---

COMMISSIONER INNIS: There was one point, Mr. O'Donnell. I do not want to drag you off the theme you have in mind, but you make something of the difference in density of traffic on the different lines, and I would suppose that it is much more important for the Canadian National to have lower rates and consequently to get say full traffic, or as much traffic as possible, than is the case with the Canadian Pacific.

MR O'DONNELL: Yes. The thing, though, of course, is that there is only one rate for everybody.

COMMISSIONER INNIS: Yes, I quite agree; but if the Canadian National is essentially a developmental line -- and I do not know how far you go along with that general idea -- it would seem that it is important from the standpoint of these new areas that are being opened up that traffic is not unduly loaded with high rates.

MR O'DONNELL: Well, I would say generally this, that the rates are not made to suit the particular case of the Canadian National, but inasmuch as there is only one rate for all railroads, then we have to operate under those rates.

COMMISSIONER INNIS: The Commission has to look at it from the standpoint of the economy of Canada.

MR O'DONNELL: Yes.

COMMISSIONER INNIS: Now, is it important from the standpoint of development of new areas, or the standpoint of the Canadian National sort of frontier roads, that rates should be perhaps rather lower than would be important for the Canadian Pacific?

MR O'DONNELL: Well, as far as the company is concerned as a company endeavouring to operate, it has to have some compensation for the fact that it is operating such lines as those to which you make reference.

COMMISSIONER INNIS: So that your subsidy to some extent permits you to develop traffic or to open up new areas.

MR O'DONNELL: Well, we have to have some assistance for the purpose of doing that, and part of the proposal, you will remember -- and I am coming to it later -- is that we should have equity financing at least for part of those lines, and not have to find all the capital by borrowing at interest rates. That is part of the proposal too. If we get the thing balanced we do not want to have it go out of line again by an accumulation of interest charges.

(Page 23963 follows)

There is no doubt about it, our rates have to be kept as low as possible, but that is not any different, I don't think, from any other carrier competing, as they are in many cases, with trucks and so on.

No, Mr. Fairweather also stated in Vol. 109 at page 20077-78 that in his view the Canadian Pacific with its higher traffic density is placed in a more favourable position than the Canadian National, and it would not be harmed by the Canadian National proposal. Mr. Fairweather concluded his remarks in the following language which is at page 20334, Vol. 111:-

"Consequently, and for that reason, rates which yield a certain return to the Canadian Pacific Railway will yield to the Canadian National a return available for fixed charges, in my opinion, somewhere between \$20 million and \$30 million a year less. If you look at that analysis of our fixed charges you find this condition. The Canadian National Railways has asked for an adjustment of its fixed charges which will reduce them in 1949, if you give credit for the \$9 million interest on the special funds which Mr. Gordon recommended, a figure of \$17,833,613. If you look at the fixed charges in the return from the Canadian Pacific Railway for 1949, you find them stated at \$14,543,817. I therefore submit that the Canadian National Railways will, on the average, have \$20 million to \$30 million less available to pay fixed charges which are greater than those of the Canadian Pacific. That is why I say that these fears of the Canadian

Pacific with regard to this modest statement of recapitalization of Canadian National and that this apprehension that it will have some terrible effect on the Canadian Pacific is something that I cannot see."

Now, that figure of \$17,833,613 that Mr. Fairweather arrives at, can easily be computed by referring to page 6 of Exhibit 254. The figure he takes there is the net figure but it can be arrived at by taking the gross fixed charges, which are stated at page 6 to be \$48, 631,896.03 and deducting from that gross figure the item of interest on Government loans of \$21,798,283, and also deducting the \$9 million to which he has made reference, that gives a net of \$17,833,613.16.

COMMISSIONER INNIS: Would you read again the first sentence of that extract you have just read?

MR. O'DONNELL: "Consequently, and for that reason, rates which yield a certain return to the Canadian Pacific Railway will yield to the Canadian National a return available for fixed charges, in my opinion, somewhere between \$20 million and \$30 million a year less."

He had pointed out just before that that this relativity of disadvantageous position will continue. Whether the population of the country grows or not, there is, in his view, that constant disability which is a continuing drain.

Now, just in connection with the quotation I have just read, this fact may also be borne in mind. It is commented upon by counsel for Manitoba when he drew

attention to the fact that the earning capacity of railway enterprises generally is substantially less than it was, say, in the 1920's or prior to the 1920's when it was still a monopoly. Competition is undoubtedly eroding the revenues of all the railways, and that is a fact that also has to be borne in mind.

Now, Mr. Fairweather also went on to say at page 20335 (and I quote in part):-

"But what I said was that, over the years, that surplus would not be substantial in amount. I would not say that it would average zero, but it certainly could not average any large amount, in my opinion, knowing what I know of the Canadian National Railways."

Further, at page 20337 he said:-

"I have already stated that our objective was a simple one. It was to give us a chance of operating without chronic deficits."

"Q. Is your answer to my question that you have not given consideration to the extent of your surplus, or what it should be?

"A. I think that would be an inference. We are content if we can operate without deficits.

"Q. Yes.

"A. If I might add to that answer, I should like to add this. It is my considered opinion that if we are desiring to put the capital structure of the Canadian National on a basis where it would be completely self-supporting, the reduction

[illegible]

1944 The American people are for many different things.

1. Was ist die Aufgabe der ... ?

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"in the capital structure would have to be more drastic than it has been suggested it should be. I have no reservations on that score. That is why I said that our reduction that we are requesting is considered as modest."

Then again:-

"If the Canadian National was earning such a figure, the Canadian Pacific would be earning a bigger figure."

That is at the bottom of that same page.

Now, as to the future prospects, and that the Canadian National might overtake and surpass the traffic density of the Canadian Pacific, as was suggested to Mr. Fairweather by Mr. Evans, Mr. Fairweather said in part at page 20344:-

".....I would add that from my size-up of the conditions in Canada as I have been studying them for years and years, it does not indicate any probability of that happening. As a matter of fact, as I have stated, I see a job of work coming along to the Canadian National Railways in the future of adding to the development of this country by extending lines, and that will dilute our traffic density, so that we will be tending to increase it in one direction by the growth of the country and we will be tending to dilute it as we have to have development lines."

Now, in reply to Dr. Innis, as to what would happen in a "downward trend", Mr. Fairweather said at page 20345:-

"Always the line with the lower traffic density suffers, and if we were faced with a reduction in revenues it would shove our operating ratio^{up}/at a faster rate than that of the Canadian Pacific in the same circumstances."

And again:-

".....and the net available for fixed charges would go down."

Now, in this connection the Commission will have in mind the testimony of Mr. Fairweather that inflation bears with particular severity upon the Canadian National by reason of its relatively low traffic density. In Vol. 109 at page 20091 and following, he discussed that, and I will not take the time of the Commission to go into it in detail, other than to point out that the reasons there given are fairly detailed and have to be borne in mind. It will also be remembered that Mr. Fairweather demonstrated the points by a tabulation which appears at page 20093. Taking two hypothetical roads of different traffic density, he demonstrated that the road with the lower traffic density suffered a greater reduction in net due to inflation than did the road having the higher traffic density. That table and his explanation will be found at the page I have just mentioned.

COMMISSIONER INNIS: He did not say whether the people on the road of a lower traffic density suffered more than the people on the road with the higher traffic density?

MR. O'DONNELL: In the way of service?

COMMISSIONER INNIS: Yes.

MR. O'DONNELL: Well, I don't remember off hand. I think he was just pointing to the railways' problem rather than to the problem of people on the line. Undoubtedly the people on the line won't get the same intensive type of service as they would if they were on a high traffic line, the main line from Toronto to Montreal, for instance.

When Mr. Evans suggested at page 20348 to Mr. Fairweather that the traffic density per mile of line measured in net ton miles of the constituent lines of the Canadian National, had increased by about 90% since 1917, as against an increase of 37% in the same term for the Canadian Pacific, Mr. Fairweather stated at the following page, 20349, in part:-

".....I still say it does not vitiate in the slightest degree my general conclusion. I do not know quite what it would mean. If you are leading from that to the inference that at some time in the reasonably foreseeable future we would overtake the traffic density of the Canadian Pacific, I would differ....."

Then at page 20359 he said in part:-

"That is one of the reasons why I say that the Canadian National outlook is not, under this capital revision, by any means a feather bed."

At page 20373 again, in part he said:-

"But the main point I wish to make in this submission was that there are inherent differences between the earning capacity of the Canadian National and that of the Canadian Pacific arising out of the difference in traffic density

and that is very substantial in peacetime, and I would not want that fact obscured, because it is a very substantial thing. All you have got to do to prove it is to consider this figure of 2383 miles additional railway that we have to operate for the same traffic density. You cannot operate a railway today at less than somewhere around \$8,000 a mile and you see there you get \$20 million difference. We have the burden of that operation without any off-setting revenue ".

Now, that statement was made by a man who has had very close connection with this problem for well nigh forty years, and I think we can take it for granted that he knows the situation of which he speaks.

Now, Mr. Fairweather said, again speaking of the extent of the relief sought by the Canadian National's proposal (and I quote again, page 20370):-

".....the relief that should be granted to the Canadian National if you wanted to look at it from the point of view of exact parity with the Canadian Pacific in all its aspects, would have to be much more substantial than is here asked for. We have not asked for any more reduction of our fixed charges than will give us a reasonable chance of avoiding deficit operation. That is the modest position we have taken."

Now, on this point, Mr. Cooper said in Vol. 115, page 20917:-

"My opinion is that by and large the Canadian National Railways would always be in the order of about \$20 million less in net income than the Canadian Pacific after the President's proposals had been put into effect, whereas there was an implication left, it seemed to me, in the evidence given by these two gentlemen - - "

(He is referring to Mr. Northey Jones and Mr. Norman)

".....that the reverse would be the situation, and I am trying to make that clear. It would not be the situation; the Canadian National will never earn as much as the Canadian Pacific in my opinion."

Mr. Cooper also said on that point at page 20894:-

"If the fixed charges of the Canadian Pacific and those of the Canadian National - -"
(the word "National" is obviously left out in the Transcript):-

"- - are approximately equal, I would say that because of the physical characteristics, density of traffic and operation of lines in the national interest, the results of operating the Canadian Pacific Railway will always be found to be more favourable than those of the Canadian National."

And he goes on:-

"My opinion is that under all foreseeable conditions the Canadian National cannot expect to show up more favourably than or even as favourably as the Canadian

Pacific."

There again, I comment that Mr. Cooper likewise has lived with the problem for many many years and knows the details both of the operations of the Canadian National since it was set up in 1923, and he was with the predecessor companies, the Grand Trunk, in the years before that.

Now, add to the views of Mr. Cooper and Mr. Fairweather, the formal submission of the Canadian National Railways as presented by its Chairman when he appeared before the Commission, which appears in Volume 98 at page 18388, and I quote:-

(Page 23973 follows)

"It is my considered opinion, concurred in by the Board of Directors, that nothing short of these measures can be deemed adequate treatment of the capital structure of Canadian National. These measures, if put into effect, should enable Canadian National, on the average, to meet its fixed charges, including interest on funded debt."

I would like to stop for a moment to consider the recommendation of the Board of Directors. I respectfully submit that this considered view should not be lightly dealt with. The names of the men who are on that directorate appear in the annual reports, Exhibit 254 and others. There is a board of seven directors. I might mention their names. They are Mr. Wilfrid Gagnon, C.B.E., Montreal; Mr. J. A. Northey, Toronto; Mr. H. J. Symington, C.M.G., K.C., Montreal; Mr. R. B. Brennan, Saint John; Mr. B. L. Daly, Montreal, and Mr. W. J. Parker, Winnipeg.

COMMISSIONER INNIS: What are the terms of office of these men? Have they all been on for some time?

MR. O'DONNELL: I was just going to comment on that. I thought it was of importance. While I have not got the detailed story, which I could get, I would say that the chairman, of course, is Mr. Gordon. The Commission is fully aware of Mr. Gordon's qualifications. After all, he has been deputy governor of the Bank of Canada for years. I would say he is a man who knows the economy of the country as well possibly as anybody. He was in charge of the Wartime Prices and Trade Board and that brought him into contact with practically every manufacturer from Halifax to Vancouver. They came there with their problems. He has had an opportunity, I say, of

getting an over-all picture of the economy of the country.

Apart from that, in so far as the balance sheet aspect of corporation affairs is concerned, I submit he is very well qualified to appraise that situation and to bring very wide judgment as to the possible division there should be between equity and borrowed capital, which is the question here.

I think Mr. H. J. Symington has been on the board for approximately fifteen years. Mr. Symington was appointed by order in council P.C. 2332, a copy of which I furnished to the Commission. That is his appointment as a director in 1936, and he has been there ever since. Mr. Symington is a man who has been closely associated with railway problems for fully thirty years. He was Manitoba's counsel in the 1920's when the fight concerning the freight situation was going on. He represented Manitoba before the Board of Transport Commissioners in the 40% Case and before the governor in council. During that four or five year period he was very closely associated with the problem.

He is a lawyer and has been closely connected with financial matters. He is vice-president of the Royal Securities Corporation, a company that has done considerable underwriting and financing of public utilities, power companies, tramway companies and that kind of thing. He is chairman of Price Bros. Paper Company. He has been connected literally with hundreds of companies, and I respectfully submit he is in a position to express a judgment on a matter of this kind, particularly as to the division between equity and borrowed capital, and so on. That is the problem which has been discussed here. During the war he was Power Controller, and he knows the problems of the public utility companies from that aspect.

He was president of Trans-Canada Air Lines. I think his experience qualifies him to express an opinion of some weight.

COMMISSIONER INNIS: He would not have much time for the Canadian National.

MR. O'DONNELL: He had plenty of time over a fifteen-year period to keep in contact with that. Mr. Gagnon is a well known industrialist and business man in Montreal. He has been on the Board for fifteen years.

COMMISSIONER INNIS: Does the Act call for five-year terms? What is the term?

MR. O'DONNELL: It has been mentioned to me that Mr. Symington was in the Grand Trunk law department before he got into these other matters. The term of the directors will be found in the Canadian National-Canadian Pacific Act, 1 Edward VIII, Chapter 25. Section 5 reads:

"6(1). Three of the original directors, including the chairman of the Board of Directors, shall be appointed for terms of three years each from appointment.

"(2) Two of the original directors shall be appointed for terms of two years each from appointment.

"(3) Two of the original directors shall be appointed for terms of one year each from appointment."

I think the endeavour was to have continuity and rotation.

COMMISSIONER INNIS: Do they come up for re-appointment?

MR. O'DONNELL: Yes.

COMMISSIONER INNIS: Every three years.

MR. O'DONNELL: Yes. Mr. Symington and Mr.

Gagnon have been there for fifteen years. I understand that Mr. Daly has also been there for about fifteen years. Mr. Northey ^{Jones} is a very well known industrialist. Mr. Brennan from the Maritimes is a well known industrialist, a man whose business judgment is respected. Mr. W. J. Parker from Winnipeg is the president of the Manitoba Pool Elevators.

COMMISSIONER INNIS: How long have they been on?

MR. O'DONNELL: Mr. Parker has just come on. I think he replaced Mr. Young. He has been there just about a year but these other men have been there for a considerable time.

COMMISSIONER INNIS: What about Mr. Brennan?

MR. O'DONNELL: He has been there three years or five years. I don't know which.

COMMISSIONER INNIS: And Mr. Northey ^{Jones}?

MR. O'DONNELL: Mr. Northey ^{Jones} has been there longer than that. I shall be glad to get the dates. All I am saying is that the board of Directors of this company have endorsed this plan and have said that it bears their approval. My understanding is that this proposal and the study of this problem were before the executive and the board for months. The executive committee met with the committee of the board, and the matter was before the board itself on several occasions, and the plan was finally endorsed. It was not anything that was just thought up lightly and put forward. It is something that has had the very studied consideration of these men. All I say respectfully is that their recommendation should not be lightly treated but should be given the sincere and earnest consideration which I respectfully submit it merits. I think these men know the problem with which they are dealing, and furthermore they have the

benefit of the detailed expert personnel of the company. It is not a new problem; it has been considered for years and years.

THE CHAIRMAN: In describing the make-up of the board you go back to the statutes of 1932-33.

MR. O'DONNELL: I mentioned that statute just now, my lord, because that is where one finds the term of office of the directors.

THE CHAIRMAN: There has been no change since then?

MR. O'DONNELL: Not in that aspect, my lord. That is a strange place to find it.

THE CHAIRMAN: That 1932-33 Act was extremely strange. That is the co-operation statute.

MR. O'DONNELL: It is very difficult to find.

THE CHAIRMAN: It is more than that.

MR. O'DONNELL: A number of other things are dealt with there. It deals with deficits, annual reports, and so on. It just so happens, I assume, that they wished to enact amendments, and they put that in this statute which has not any specific reference to the Canadian National Railways as such.

THE CHAIRMAN: Does this Act not create trustees?

MR. O'DONNELL: The original set-up was trustees.

THE CHAIRMAN: Then you have it as amended?

MR. O'DONNELL: That is right. Now they are directors.

THE CHAIRMAN: The change was made in 1936.

MR. O'DONNELL: Yes, my lord. A part of this Act deals with the corporate set-up of the Canadian National Railways. Then there are other provisions which deal with co-operation between the two railways. The Act that I refer to is the one passed in 1936. I turn

now to the next item --

THE CHAIRMAN: I am sorry to interrupt. I see that the present set-up was established in 1936.

MR. O'DONNELL: Correct.

THE CHAIRMAN: Although the Act is talked about as the Act of 1933. It is really very different now.

MR. O'DONNELL: Yes, the Act of 1933 was repealed, and we have a whole array of provisions.

THE CHAIRMAN: The caption says, "This Act may be cited as the Canadian National -Canadian Pacific Act, 1933."

MR. O'DONNELL: That is right.

THE CHAIRMAN: As a matter of fact, when you look into it, so far as the Canadian National set-up is concerned, it was very considerably altered in 1936.

MR. O'DONNELL: That is right, my lord. Instead of making the alterations in the Canadian National Railways Act itself they were put into this Act.

THE CHAIRMAN: Yes, I see that.

MR. O'DONNELL: I think you will remember that the original Canadian National-Canadian Pacific Act of 1933 supplemented in part the recommendations of the Duff Commission. I think that is why it is all lumped together in that way. Then later on --

THE CHAIRMAN: Pardon me a moment. It is the recommendations of the Duff Commission in two particulars, about recasting the C.N.R. and providing for co-operation.

MR. O'DONNELL: Generally speaking that is right.

THE CHAIRMAN: And the co-operation part of the statute has not been changed?

MR. O'DONNELL: Offhand I do not think so, my lord. There were other amendments.

THE CHAIRMAN: To the co-operation part?

MR. O'DONNELL: You have the consolidation there of the whole thing in the booklet we have provided. There were amendments to the Act in 1936, 1939 and 1947.

THE CHAIRMAN: Including amendments to the co-operation part?

MR. O'DONNELL: Yes, I think so, my lord. You have been provided with a consolidation in the book that we put together containing the relevant statutes.

The next matter I come to is under the heading of comparability with other railways. That the fixed charges of the Canadian National Railways at the present time are excessive and completely out of line with those of other major railways in North America I submit is beyond question.

COMMISSIONER ANGUS: Would you say comparability is advisable or not advisable?

MR. O'DONNELL: The Commission has been directed in these terms, to review and report on the advisability of establishing and maintaining the fixed charges of that company on a basis comparable to other railways in North America. Just what the mandate is --

THE CHAIRMAN: What side are you on?

MR. O'DONNELL: I am on this side, that I have before me the problem of this railway, which has in some respects very special features but which has to have an adjustment that suits it. I do not know exactly what comparability really means when you get down to that. The point is there are numerous ways of comparing. I am going on to discuss that, and just what comparability means the Commission will have to determine in the final analysis.

COMMISSIONER ANGUS: You have put forward some very clear-cut proposals. Are they sailing under the flag

of comparability or under the flag of non-comparability?

MR. O'DONNELL: I think the Commission will have to decide what flag they are sailing under. We say in the final analysis that we put forward proposals that will assist us to service a fixed charge of so much, and that taking the average over the years we can expect to carry on under the proposals we have made. I intend to put the view as we understand it and then see how far that may lead to other questions that you are entitled to refer to as we go along. I say simply that we are out of line on one basis at least with other railways in North America.

I think the matter has been exhaustively dealt with in the Canadian National submission, Exhibit 214, and the Commission will have in mind the fairly detailed study which appears between pages 12 and 64. It is not my intention to review in any considerable detail the facts and figures which are set forth in the brief as I assume they will receive the very careful consideration of the Commission. Moreover the subject was discussed in a very complete manner by Mr. Cooper in his evidence before the Commission which will be found in Volume 99 between pages 18537 and 18643, and continuing into Volume 100 to page 18663. Numerous exhibits supporting his declarations and statements were filed by Mr. Cooper, and the attention of the Commission is in particular respectfully directed to Exhibits 222 to 248 both inclusive.

With the permission of the Commission I shall read briefly from the cross-examination of Mr. Cooper by Mr. Covert where I think the situation is pointed up fairly clearly. I begin at page 18800, and the reference is to the figures that are set out on page 54 of

Exhibit 214, the main brief.

"Q. You compare the fixed charges, the gross revenues and the ratio; --"

That is on page 54 of the brief.

" -- and I think, brought up to date that is now 9.43 for the Canadian National; 4.18 for the Canadian Pacific, and 4.4 for the Class 1 roads." That is the comparison of the fixed charges and gross revenues and the ratio resulting.

"A. Yes.

"Q. So that the position is that the Canadian National's ratio is more than twice that of the Canadian Pacific?

"A. More than twice that of the Canadian Pacific and more than twice that of the Class 1 roads.

"Q. Then at page 55 you list the five roads there?

"A. Yes.

"Q. And according to these figures, the ratio with respect to those five roads varies from 7.88 down to 1.89?

"A. Yes.

"Q. For instance, comparing the ratio for the Pennsylvania Railroad with that of the Atchison, Topeka and Santa Fe System, we find that there is a variance in the ratio of the two roads to the extent that one is four times the other?

"A. Taking those particular roads, yes. The Pennsylvania and the Canadian National do not show the same disparity as if you took the Class 1 roads as a group. On the other hand,

if you take -- "

Then I jump the irrelevant words.

" -- the road with the most favourable ratio, the Santa Fe, then our position by comparison is just that much worse."

Further Mr. Cooper said:

"If you compare the Canadian National with the Santa Fe by itself, their ratio in 1947 was 1.89 whereas ours was 10.48.

"Mr. Covert: Q. If you compare the Canadian National, the Canadian Pacific and the Santa Fe in 1947, you would have the figures of 10.48, 4.60 and 1.89?

"A. Yes.

"Q. Is that not a fairly clear indication in itself that there really is no true ratio, that the ratios themselves are not comparable?

"A. That is why I took the Class 1 roads as a group.

"Q. Yes.

"A. I think that to compare the Canadian National with those five large United States railroads, you have so much difference in the comparative results that it is very difficult to draw a conclusion, except that the Canadian National, by any measurement, is out of line. But if you take the Class 1 roads as a group, I am submitting that that is the best thing you can do. If there is a better method, I should be very happy to produce the figures. But I cannot think of any better comparison than to take the Class 1 roads of the United States as a group and compare them with the Canadian

National. In the group you have the good and the bad; you have the rich roads and the poor roads. By and large you have the United States railroads as a whole. By measurement the Canadian National Railways is about one-tenth of the Class 1 roads; and it is my submission that that is the best basis for comparison that I can suggest."

Mr. Cooper was comparing there the fixed charges with the gross revenues. At page 53 to 55 of the main brief the Commission will remember that Mr. Cooper gave detailed figures as to comparison which the Commission will undoubtedly have to consider and review. Then at the bottom of page 55 of the brief there is the following:

"It will be noted that on any basis of comparison the ratio for the Canadian National is completely out of line with other major railways in North America."

As I said, my lord, the matter is so notorious and the record is so demonstrative of the very adverse situation faced by the Canadian National in this respect that I do not intend to devote any more time to it. The details are in the brief at the pages to which I refer. I submit that both the main submission and the lengthy testimony of Mr. Cooper establish beyond any doubt what the situation is, and it will be recalled that upon this feature he was not challenged, that the removal of the entire interest-bearing debt presently held by the government, being \$760 million, would still not achieve reasonable comparability with other major lines in North America on the basis of comparisons of fixed charges to gross revenues.

COMMISSIONER INNIS: Have you compared equity capital as well?

MR. O'DONNELL: Have we compared it?

COMMISSIONER INNIS: Yes.

MR. O'DONNELL: I do not think I have any figures other than those in the exhibits to which I shall refer. There was a series of exhibits, but I do not think we have any detail on the equity aspect of it.

COMMISSIONER INNIS: One would like to see the picture of the whole situation.

MR. O'DONNELL: I could have that information procured in so far as possible and file it with the Commission if you would like to have it.

THE CHAIRMAN: The point is that we are asked to establish your fixed charges on a basis comparable to other major railways, and you have simply shown us your gross revenues and fixed charges.

MR. O'DONNELL: I am coming to some other comparisons. I say that is only one of the factors. In answer to Commissioner Innis I do not think we assembled information to show the division between equity and borrowed capital of these other lines. We can do that. I do not think we did because frankly we had a little difficulty understanding exactly what the word "comparability" meant. We put it on a number of bases. I think there are many ways that comparisons can be made. We took a number of them and reviewed those. Undoubtedly there are others.

THE CHAIRMAN: When you have done that, when you have put it on a number of bases then I suppose you conclude that the result would justify the reconstruction that is outlined in Mr. Gordon's statement.

MR. O'DONNELL: That is our view. If in the

final analysis our proposal is put into effect one hundred per cent it would permit us to service the fixed charge that we end up with as a result of putting the proposal into effect. We think that on the average we can earn enough to meet the fixed charges that would result from the proposal, and that is finally the way we put the proposal to the Commission. As I said, if the Commission wishes me to assemble that information I would try to get the division between equity and borrowed capital for all these different lines.

COMMISSIONER INNIS: I would rather like to see that.

MR. O'DONNELL: I shall be glad to arrange to do it. It may take a little time to get it but we will be glad to submit it to the Commission.

(Page 23990 follows)

Now, my friend Mr. Covert draws to my attention that there are percentage figures now in the record at page 49 of the main brief giving the percentage of capitalization represented by equity capital and funded debt but it is not in dollars.

COMMISSIONER INNIS: How would your proposal work out in relation to that?

Mr. O'DONNELL: I am coming to that and I would say this frankly, that if after the Commission has heard what we have to say there is anything you would like us to find, we will be glad to endeavour to get it. It was a bit difficult to know exactly what line to present the case on in the light of the direction in the Order in Council - as to exactly what comparability was and what would be considered as being the data that should be submitted to permit a study. It was difficult to determine so that if there is anything else that the Commission thinks we should provide, we will be glad to endeavour to get it.

To return to what I was saying about Mr. Cooper, I submitted that the removal of the entire interest-bearing debt presently held by the government, being \$760,000,000 will not achieve reasonable comparability. Now, were such adjustment alone - were only that adjustment to be made, the proportion of gross earnings of the Canadian National required to pay fixed charges would be considerably in excess of the Canadian Pacific Railway Company or Class I roads.

The Commission will remember the figures which are set out at page 63 of the Brief where the proportion of gross earnings required to pay fixed charges and a number of other comparisons appear. Mr. Cooper testified that in effect the proportion of the 1947 gross earnings for the Canadian National required to pay fixed charges was 5.9 per cent, that for the Canadian Pacific was 4.6 per cent and

for the Class I United States roads it would be 5.03 per cent.

He further said that the figures for 1948, which I think the Commission inserted on the face of the Brief at the time, for 1948 would be - Canadian National Railways 5.03 per cent; Canadian Pacific Railway Company 4.18 per cent and United States Class I roads 4.40 per cent.

Mr. Cooper's testimony in this connection is in Volume 99 at page 18642.

Now, these figures at the top of page 63 of the Brief which are a restatement on the basis that the government investment in the Canadian National was represented by capital stock instead of interest-bearing loans (page 62 of the Brief) are ample evidence to the effect that an adjustment confined to the bonded indebtedness held by the government will fail to establish Canadian National fixed charges on a basis of comparability with those of to other railways.

Such treatment of the problem would still leave the debt in the hands of the public unadjusted and this, altogether apart from any consideration being given to the Canadian National for the operation of thin traffic lines operated in the national interest. That is, the negative capital burden would be ignored and no proper allowance made to affect it.

In this connection I say it is pertinent to remember the statement made by Mr. Cooper in Volume 115 at page 20894. Mr. Cooper there said:

"If the fixed charges of the Canadian Pacific and those of the Canadian National are approximately equal, I would say that because of the physical characteristics, density of traffic and operation of lines in the national interest, the results of operating the Canadian Pacific Railway will always be found to be more

favourable than those of the Canadian National."

I referred to this statement some time back but I point it out at this point because Mr. Gordon's proposal and the Canadian National proposal has been put forward as an adjustment to offset that particular situation. It is designed to deal with the over-all problem and to produce a reasonably acceptable solution because if we dealt only with the securities that are in the hands of the government at the present time, we would, as I said, completely overlook or not deal with any adjustment of the debt that is in the hands of the public and we would have no consideration for the operation of these thin traffic lines which are operated in the national interest.

The claim, as we had reviewed it yesterday, you will remember totalled \$1,533,000,000 and adjustment, as proposed, would accord relief to the extent of \$1,060,000,000 and nothing less than that in the considered view of the Canadian National would be adequate in the circumstances.

COMMISSIONER INNIS: Can you tell us a little bit more about the \$760,000,000? When was that repatriated?

Mr. O'DONNELL: The \$760,000,000 - some major portion of it was repatriated during the war. I have not the details as to the exact dollars. I will try to find out. I do happen to know that at the present time the government has that amount of securities in its hand - \$760,000,000. The build-up or order of how it was accumulated I have not the information. I would be glad to try to get it.

COMMISSIONER INNIS: It all came in since the war?

Mr. O'DONNELL: That I do not know either, Dr. Innis. I understand it might not all have been since the war. There might have been some taken in prior to the war but as a result of the war it became possible for the government to get in under repatriation financing a considerable portion

of it but that is information which can be obtained either by the Commission or by us, if you would like us to try to get it but the point, as far as we are concerned, is that at the present time there happens to be in the hands of the government \$760,000,000.

If there were more in the hands of the government, then that would facilitate dealing with it even more than this. I will put it this way: If the government had \$1,060,000,000 in its hands, the problem would be even more simplified because we would exchange on our proposal - they would take equity for that funded debt - they would surrender the obligation that calls for a payment of interest to us and receive the shares of the capital stock in exchange.

That would simplify the situation but it is in view of the fact that the government only has the \$760,000,000 in its hands that we try to get the relief we need which we say is \$1,060,000,000. We try to get it by this method of setting up a \$300,000,000 reserve or credit which will produce the relief that we say we need.

COMMISSIONER INNIS: What sort of scheme did you have before the government got hold of this money?

Mr. O'DONNELL: Well, I don't know. There have been suggestions through the years that an adjustment should be made but I do not think it ever got down to the point - we have in the record the proposal that Sir Henry Thornton made and I put on the record a mass of detail of that kind to show through the course of the years the various approaches that have been taken to it but I do not think it ever got to the formalized proposal such as is now submitted. Nobody in effect had the authority to accept a recommendation of this kind on the over-all picture.

It was dealt with in bits and pieces and considered from various points of view, but it was never submitted in the formalized way it is now before your Commission.

COMMISSIONER INNIS: But you could not have submitted it in this fashion unless---

MR O'DONNELL: That is right. Mr. Cooper, as I remember the evidence, said through the years it was impossible to deal with the thing, by reason of the fact that in the hands of the public there were considerably more of these securities than there are at the present time, and he points to the fact that at the present time -- and Mr. Fairweather said the same thing -- the problem is facilitated to that extent.

Now, I have reviewed the matter and have referred the Commission respectively to the pages in the record and in the main brief where the data that was submitted for your consideration is to be found. Having reviewed that, and having reviewed the proposal at length, having shown what the situation is prior to the adjustment, let us take a look at the situation after the proposal has been implemented.

When we come to the matter of comparability with other railways we must look first at the figures which state the comparison expressed as a percentage of gross revenues. That is what was done there, and those figures that we have set out in the brief in part refer to the comparison between fixed charges and gross revenues.

In 1948, ^{with} the railway's proposal implemented, the comparisons would have been as follows:

| | |
|-------------------|--------|
| Canadian National | 3.20% |
| Canadian Pacific | 4.18% |
| Class I Roads | 4.40%. |

Now, at first glance these figures seem to indi-

cate the proposals if implemented would place the Canadian National in a more favourable position than that of other roads. A comparison of fixed charges to gross revenues, however, I say gives no recognition to the disabilities of the Canadian National which are reflected in operating expenses, and that comparison of fixed charges to gross revenues is merely one method of comparing, and it would give no consideration or recognition to the disabilities of the Canadian National which are reflected in the operating expenses.

The ratio used uses two factors, gross revenues and fixed charges. Now, there is a third factor which comes into play if the results of one railway are to be compared with those of another. The third factor is operating expenses. Unless there is comparability in the operating conditions which are reflected in operating expenses, then obviously the financial results will not be fully comparable, even though comparability exists as to fixed charges in relation to gross revenues. That other factor comes into play.

I have presented here through our witnesses a mass of evidence to show the Commission the disadvantages under which we labour in respect of the operating disabilities of the Canadian National compared with the Canadian Pacific.

I refer to Mr. Cooper's evidence in volume 115, at page 20894, where he stated:

"If the fixed charges of the Canadian Pacific and those of the Canadian National are approximately equal, I would say that because of the physical characteristics, density of traffic and operation of lines in the national interest, the results of operating the Canadian Pacific Railway will always be

found to be more favourable than those of the Canadian National."

This second basis of comparison I am now referring to is generally referred to by railway people, as I said, as the operating ratio. If the operating ratio of the two railways is approximately equal, and if the ratio of fixed charges to gross revenues of the two railways is approximately equal, then and only then -- I emphasize that, only then -- will the end results be truly comparable.

Now, I have ^{had} prepared an exhibit which I now produce, and which I would ask to have filed as Exhibit 288, showing the operating ratios of the Canadian National, the Canadian Pacific and Class I Roads for the period 1923-1948.

EXHIBIT No.288: Statement - Ratio of Operating Expenses to Revenues, 1923-48, C.N.R., C.P.R. and U.S. Class I Roads.

MR O'DONNELL: The Commission will see from this exhibit that for the period 1923-1948 the average operating ratios were, Canadian National 86.87 -- that is the bottom figure in the third column of figures, under the heading "Operating Ratio" -- Canadian Pacific 79.71, and the Class I Roads 73.47. The ratio for the Canadian National, of course, is affected adversely by special operating disabilities which we have discussed in these proceedings. If the operating ratio of the Canadian National had been equal to that of the Canadian Pacific, namely, 79.71 per cent instead of what it was, namely 86.87 per cent, then the net revenues of the Canadian National would have been about \$20 million a year greater than they were. Therefore in this matter of comparability, my lord and members of the Commission, I submit that it is not sufficient merely to compare the ratio which fixed charges bears to gross revenues. Regard must also be had to the operating expense side of the

picture. In the terms of reference there is no suggestion that comparability of fixed charges must be considered only in relation to gross earnings. The expense side must also be considered. Comparability must comprehend all the factors involved in railway operation.

In this connection the Commission will remember that I produced Exhibits 236 to 242, which are a series of exhibits which study various comparisons of the different roads, the Canadian National and the Canadian Pacific and the Class I Roads.

For instance, we have Exhibit 236, which is a comparison of the earnings per mile of road operated.

We have the further comparison of Exhibit 237, of revenue ton miles per mile of road operated.

We have Exhibit 238, revenue passenger miles per mile of road operated.

We have Exhibit 239, freight revenue per ton mile.

We have also Exhibit 240, revenue per passenger mile.

Then we have also Exhibit 241, which is the study of the ratio of fixed charges to gross revenues of the same classifications.

Then we have further Exhibit 242, which is the comparison of the data concerning the five American roads that are mentioned in the brief.

Now, all these exhibits are studies of comparisons of these three groups, the Canadian National, the Canadian Pacific and the Class I roads, approached from various points of view.

(Recess)

(Page 24002 follows)

THE CHAIRMAN: All right, Mr. O'Donnell.

MR. O'DONNELL: May it please the Commission, I think at the adjournment I had just remarked that in the terms of reference there is no suggestion that comparability of fixed charges must be considered only in relation to gross earnings, and I said the expense side must also be considered; the comparability must apprehend all the factors involved in railway operation.

Now, in connection with Exhibit 288 which I had just produced, I would ask the Commission to be good enough to bear in mind when considering that exhibit the remarks made by Mr. Cooper concerning the changes in operating expenses which have taken place in so far as the Canadian National is concerned during the last few years. For instance, the matter of depreciation accounting, and the additional charges to expenses that that involves, and which has only come into play since, I think, 1941, and that is about \$5 million a year. Then there was the further matter of pensions which Mr. Cooper referred to and which have risen from \$652,000 a year to about \$11 million a year. I mentioned that yesterday -- I have not the page reference. Then there is also the recent matter of Newfoundland which amounts to about \$4 million a year and the Temiscouata Railway, about \$180,000 a year.

Now, when considering this Exhibit 288 and the operating ratios that are set out there, those facts should be borne in mind. So that as far as I am concerned, I submit with deference that it really gets back to what I said yesterday, that Mr. Gordon his Board of Directors and the executive officers of the Railway, have given this matter their very earnest consideration over a very long period of time. It is undoubtedly a most complex

problem in evaluating all these various factors. It extends into all the ramifications of railway finance and railway operation, much of which is highly technical. Now, having given it a good deal of consideration for a lengthy period of time, and drawing on their knowledge and on their experience, using their best judgment and using it with the full sense of responsibility: they place their recommendations before this Commission for consideration.

It would possibly have been settled a long time ago if it had been an easy problem. The fact that it has persisted year after year, obtruding itself in so many ways into our national affairs, indicates, I think, some of its complexities. But at the present time, with the facts as they are, with the securities that are in the hands of the Government, the matter is considerably simplified so far as the settlement is concerned.

Now, it is my respectful submission, my lord and members of the Commission, that in your consideration of this problem you can well place great dependence on the considered views of the responsible and qualified executive officers of the railway organization, and on the aspect personnel that is available to them for the sifting of all the details that go to the study of a thing of this kind. As I also said, the measure of relief is not a figure which can be determined with mathematical exactitude. It will not conform to any formula, will not be a statistical average; it will represent an opinion based on experience, knowledge and on good judgment. That is what I submit respectfully you have before you in the proposal as finally presented by Mr. Gordon.

Now, there is one other aspect that I might

mention by way of an approach to the matter, further data that is similar possibly to that which is set out in these exhibits that I referred to a while ago, Exhibits 236-242. That is this fact, that the Canadian Pacific has an advantage over the Canadian National as a result of traffic density and as a result of other features referred to by Mr. Fairweather, of about \$20 million a year. Now, that can be translated into a figure of about \$830 per mile per year of Canadian National mileage. The significance of this statement is that it expresses in dollars the difference between the operating ratios of the two Canadian railways generally speaking.

Now, another test as to the comparability, following the implementation of the company's proposal, is that if the proposal of the Canadian National be implemented, the rail line fixed charges per mile of the C.P.R. would be considerably lower than those of the C.N.R. I submit they would be as follows:

RAIL LINE FIXED CHARGES
PER MILE

| | |
|--|--------|
| C. P. R. | \$ 687 |
| C.N.R. System on recapitalized basis | \$ 746 |
| C.N.R. System on recapitalized basis excluding the entrusted lines | \$946. |

Now, I give those figures to the Commission as another aspect, another method of approaching it or endeavouring to determine what comparability is and what comparability means. Those figures were compiled by Mr. Fairweather, and I might put on the record, if the Commission is interested, the detail as to the manner in which the computation is made.

Mr. Fairweather takes first the Canadian Pacific

rail line fixed charges, 1949 (authority -- submissions to the Royal Commission), \$11,700,000. That figure of \$11,700,000 is the figure the Board of Transport Commissioners said was the proper apportionment of fixed charges in so far as rail assets were concerned. Then Mr. Fairweather takes the miles of road operated, 17,031; the average fixed charges per mile, that is dividing the \$11,700,000 by 17,031 miles, giving the resulting figure of \$687.

Then, taking the Canadian National System on recapitalized basis including all mileage:-

| | | |
|--|---------------------|--------------|
| Fixed Charges - 1949 | \$48,631,896 | |
| (That figure is found in Exhibit 254, page 6) | | |
| <u>Loss</u> relief to be granted by recapitalization | <u>\$30,798,283</u> | \$17,833,613 |
| Miles of road operated - 1949 | | 23,902 |
| Average fixed charges per mile (that is (\$17,833,613 divided by 23,902) | | \$746 |

On the other basis, excluding the entrusted lines, Canadian National System on recapitalized basis excluding entrusted lines:-

| | |
|---------------------------------|--------------|
| Fixed charges - 1949 (as above) | \$17,833,613 |
| Miles of road operated in 1949 | 18,848 |

That is made up in this way:-

| | |
|---------------------------------------|--------------|
| Mileage as above | |
| <u>Less</u> entrusted lines | 23,902 |
| mileage: Canadian Government Railways | 4,349 |
| Newfoundland Railway | <u>705</u> |
| | <u>5,054</u> |
| | 18,848 |

(I draw the attention of the Commission to the fact that the Temiscouata figures have not been included in this computation).

Average fixed charges per mile

(\$17,833,613 divided by 18,848)

\$946

That gives the figure I mentioned previously of \$946.

So that on that basis of rail line fixed charges per mile, if the proposals of the C.N.R. are put into effect, they would be higher than the C.P.R. The C.P.R. would be \$687; the C.N.R. System on recapitalized basis, \$746; or if we deduct or exclude entrusted lines, the C.N.R. System on recapitalized basis would have rail line fixed charges per mile of \$946.

COMMISSIONER ANGUS: Mr. O'Donnell, do you think that this proposal that you have described as a simple remedy and as a compromise proposal, has among its merits the setting up of the best type of comparability between the two big railways in Canada?

MR. O'DONNELL: Well, I think that we have endeavoured to approach it from quite a number of angles insofar as trying to assess the differences.

COMMISSIONER ANGUS: Would you consider that a fair one?

MR. O'DONNELL: Well, we consider that the proposal as submitted is fair, is reasonable, will give us a fair chance to do the job we are supposed to do, and that it will not adversely affect the other road as it has been suggested it may. That is the considered view of all the officers of the company, concurred in by our Board; and, as I think the record shows, we have approached it from quite a number of different angles. If anybody knows what the C.N.R. can do, what is its reaction to circumstances, varying and changing conditions, I think the two gentlemen who were here, the Senior Executive Officers who have lived with the problem for so many years, are the best qualified people

that I can think of to assess the situation, and their considered view is as given.

COMMISSIONER ANGUS: I am not quite sure that that answers my question, if indeed it is capable of being answered.

MR. O'DONNELL: Well, I am sorry - -

COMMISSIONER ANGUS: And that is this, is it part of the object here to enable the ordinary citizens of Canada to make comparisons between the two railways and their results, which will not be misleading? Is comparability in that sense one of the objectives, or is it something that has been, if you like, disregarded because it is not a practicable thing?

MR. O'DONNELL: I think it puts the comparison of the operations of the roads on a very easily assessable plane. Now, there are these differences, I agree with you, Dr. Angus, that there are other factors. For instance, the income tax aspect, that is not in play at all times here. But as far as comparing railway operations, net operating income is concerned, we suggest that this proposal will give a good view of what our comparative positions are as to earnings which these two roads make from their railway operations.

COMMISSIONER ANGUS: I asked my question partly because of that net operating income.

MR. O'DONNELL: Yes.

COMMISSIONER ANGUS: Because non-Government railways have to use their net operating income, first of all, to pay the interest on fixed interest bonds; and then they usually have other securities forming a sort of hierarchy with different degrees of compulsion. The main criticism that has been made of your proposal,

as I understand it, is that you jump from fixed charges to this vague equity stock which exists in large quantities and/^{to}which payments to the Government are not related as percentage payments and so on. Is it desirable in the interests of comparability of results, to have perhaps income bonds, to have securities that would show what was being done with the earnings that might occur over and above fixed charges?

(Page 24010 follows)

Mr. O'DONNELL: Well, all I say, Dr. Angus, on that score is this: There might be a company that would have no fixed charges whatsoever and that would be represented solely by equity stock. We say that we could contend with that situation here both in the light of what we are faced with - on the other hand, we say we have assessed that and we say:

"We think we can carry and service a certain percentage of interest-bearing debt. That is inherent in the proposal."

Now, there are other companies that have varying types of setup. For instance, we have in the Canadian Pacific Railway's case ordinary stock. We have ordinary stock. They have preference stock; we have no preference stock. I do not think there is any place for preference stock. We have a certain amount of interest-bearing debt and the balance we have is equity.

Now, we think that with the setup that we have proposed, that is what our particular trouble calls for. We say we have reviewed it and we think we can service the amount that will be left to bear the interest charges and in so far as our owner is concerned, the owner has the entire equity that remains and the owner's equity is represented by or will be on our proposal, this equity stock and that permits, in so far as earnings are concerned, a reasonable comparison and an easy comparison with the other roads.

THE CHAIRMAN: What difference will there be between this . . . proposed stock and the stock now held?

Mr. O'DONNELL: There won't be any real difference. It is the same thing. You will remember, my lord, exhibit 245 and I have had copies prepared for the convenience of the Commission. I have had copies of the balance sheet -

245, and the income account prepared for the benefit of the Commission. It would record, however, the change that has to be recorded in the balance sheet when we switch from interest-bearing debt to equity.

If your lordship would look at exhibit 245, you will see there quite readily what is proposed. We have, for instance, the first column. That is the situation as it is today. Now, it is proposed to change the interest-bearing securities and to increase the equity and the changes that are set out there are to record that situation and if your lordship will look then at the end column, the third column, it makes a very much simpler proposition. This, of course, takes into effect the Canadian National Railways Securities Trust which is a separate item I will talk about later. It simplifies the balance sheet considerably and it permits of much easier comparison and examination and it does away in as far as the income account is concerned, with that heavy interest-bearing charge which we say has been there for years and which is not properly something related to current operating conditions and should not be in current operating expenses.

COMMISSIONER ANGUS: Some of your equity securities and stocks represent assets that have no earning power and some of them present assets that are expected to have earning power?

Mr. O'DONNELL: That is true. We have taken the over-all picture.

COMMISSIONER ANGUS: Do you think it is advisable to distinguish between those two types?

Mr. O'DONNELL: The point, Dr. Angus, is that it is rather difficult to do. This plan we have, we say, places the railway in, to all intents and purposes, just as satisfactory a position as if a very extensive scientifically

approached study had attempted to be made. Over the period of years that this thing covers it is so difficult to reach exactitude on those items and the position is that in the result this plan that is proposed will do justice to the railroad and is fair and reasonable, and, in so far as the owner is concerned, it reflects the position as between the owner and the Company.

THE CHAIRMAN: In that case, Mr. O'Donnell, I notice there is an item of \$4,500,000 capital stock of subsidiary companies operated by the public?

Mr. O'DONNELL: Yes, My lord.

THE CHAIRMAN: What is the plight of those?

Mr. O'DONNELL: They are not affected at all by the proposal.

THE CHAIRMAN: What is happening to them?

Mr. O'DONNELL: Well, the public that holds them is holding them and those various companies -

THE CHAIRMAN: Are they getting anything for them?

Mr. O'DONNELL: You mean in the way of a return?

THE CHAIRMAN: Yes.

Mr. O'DONNELL: I do not know off hand, My lord, and you will remember that the company comprises eighty odd companies and there are some of the shares which are owned by the public. There are not very many items.

THE CHAIRMAN: There is \$4,500,000 worth?

Mr. O'DONNELL: Yes.

THE CHAIRMAN: I suppose they are shares that have some par value?

Mr. O'DONNELL: They have some value and they have to be reflected in the balance sheet.

THE CHAIRMAN: Well, does anything ever happen to those? Do they ever get any dividends?

Mr. O'DONNELL: Well, they are the shares of the various

constituent companies and I suppose that if the various -

THE CHAIRMAN: Are they still keeping alive and active?

Mr. O'DONNELL: Yes, my lord, I think so, and we report annually on a consolidated basis but those different companies all have to have their own accounts kept and there is a minority interest which cannot be prejudiced. We cannot treat them unfairly. For instance, you will see, my lord, if you look at Exhibit 254 on pages 32 and 33 that there are a number of these companies, some portion of the capital stock of which is held by the public.

THE CHAIRMAN: Would you just name a few of them to me?

Mr. O'DONNELL: Well, the Montreal Warehousing Company. I am informed that that is about the only one that does get a dividend .

THE CHAIRMAN: Are any of them railways?

Mr. O'DONNELL: Yes, there is the Canadian Northern Quebec Railway Company wherethe public owns \$384,900 in round figures and my understanding is that that is not of any real value. There are nine, if my count be right, on the face of page 32.

THE CHAIRMAN: Do these shareholders ever become articulate? Do they ever say anything or askany questions?

Mr. O'DONNELL: Well, they are not shareholders of the Canadian National Railways.

THE CHAIRMAN: I know they are not.

Mr. O'DONNELL: And, I do not know - I have never been to any of the meetings -

THE CHAIRMAN: Their railway has become a subsidiary of the Canadian National?

Mr. O'DONNELL: To all intents and purposes.

THE CHAIRMAN: Well, you call it so?

Mr. O'DONNELL: Yes.

THE CHAIRMAN: You never hear from them?

Mr. O'DONNELL: Well, most of them are worthless. They have to be kept for purposes of the record - their accounts have to be kept. They are operated by us.

THE CHAIRMAN: That is all the interest you have in them?

Mr. O'DONNELL: We operate them as best we can.

THE CHAIRMAN: So far as the shares are concerned?

Mr. O'DONNELL: Yes, my lord. There is that minority interest in some of them that cannot be disregarded and until that minority interest surrenders its holdings, they are shareholders and they have got to be treated fairly.

COMMISSIONER ANGUS: Mr. O'Donnell, if you had financed or had a capital structure that had no fixed charges saying simply "This is a government road. The government is owner. The government has assumed responsibility for these bonds in the hands of the public. We have given them capital stock in exchange; that is our only security." Supposing that had happened would not you then defend that setup on the ground that it eliminates false comparability that here you have a government railway that is clearly distinguished from a private railway and that shows the real effects of what a government railway is. That is the way it would be defended, would it not?

Mr. O'DONNELL: That might be one way of defending it. It may be a perfectly proper way to set it up. I do not know.

COMMISSIONER ANGUS: If we were to find that comparability was not advisable, would not that be the attractive solution?

Mr. O'DONNELL: Well, the only attractive solution that I am authorized to speak to and for is the one we have put forward and all I am saying, Dr. Angus, is that the men who know (I don't know; I am just speaking on what the record shows and on what I am instructed) - the men who know say that this proposal which is put forward is a fair

and real proposal.

THE CHAIRMAN: And they are not in a position to discuss other proposals?

Mr. O'DONNELL: Other proposals may be discussed and I am quite prepared to try to discuss them. I suppose there are numerous ways that one could solve this problem. But if the Canadian National's solution is asked for, then it is as has been put forward and I say that it has had the most careful consideration by us and is a proposal that we submit is the one that should be recommended.

Now, if other persons have other views, that is something else. No other views have been put forward here other than the admonition or warning to the Commission that in following the proposal of the Canadian National Railways it may have effects on other persons but there has been no alternative view put forward here. This is the only view and the only proposal and it is the proposal of the person, the entity most concerned, the Canadian National itself.

THE CHAIRMAN: I do not know if there was anybody before us who was in a position to put forward any other proposal.

Mr. O'DONNELL: That may be, my lord, but, on the other hand, all I am saying is that our officers - men, I submit, of integrity and judgment and experience, qualified to put their view forward - have come in, given you the benefit of their help so far as they can. They have said why they think this is a reasonable proposal.

THE CHAIRMAN: Do you think that anybody before us may been actuated by this particular clause in the Order in Council? What I mean to say is this: You must always read the Order in Council in its entirety and these particular commitments are not to encroach upon the generality of the terms of the Order in Council so that even if that Clause (c) of paragraph 2 were not there, you would still be permitted

in the very general instructions you have received to go into this?

Mr. O'DONNELL: I think so, my lord, and it so happens, as far as I am concerned, that our proposal meets both accounts. It meets the submission under the general powers given to the Commission and it also meets the submission under the special powers under subsection 2(c).

(24017 follows)

The proposal that we put is the view that our officers and our company feel is the best they can devise, and we say, or they say, that if they get that proposal implemented the results that they expect are as they have testified to here.

COMMISSIONER ANGUS: It might well be the best that could be devised without having the virtue of comparability, or even in spite of suggesting some false comparisons, it might still be the best.

MR O'DONNELL: I think it is the best any way you look at it; that is my appreciation of it.

COMMISSIONER ANGUS: Can you at all discuss whether it has that particular merit of establishing a useful comparability between the two railways

MR O'DONNELL: Well, it depends upon what one understands by comparability. Now, we have given the Commission comparisons, six or seven or eight or more, taking various aspects of railway operations and various aspects of railway finance. We have looked at it from the point of view of operating ratio, we have looked at it from the point of view of revenue per ton mile, from the point of view of returns per passenger mile, and freight revenue -- any number of ways we have approached it, and we say that, depending upon what precise connotation is given to the word "comparability", one approaches it one way or another; but we have tried to put before the Commission quite a number of tests, and we say that on any test our plan is fair and reasonable.

COMMISSIONER ANGUS: For instance, among the many merits that you claim for it, there is not the merit of it setting up a yardstick for just and reasonable rates.

MR O'DONNELL: We said that from the very beginning.

COMMISSIONER ANGUS: You have said that very frankly.

MR O'DONNELL: We said that very frankly; we said that is another problem.

COMMISSIONER ANGUS: I am asking about this particular merit. Has it comparability in a useful sense, in the sense of helping the general public to understand the railway situation?

MR O'DONNELL: I think it would show to the general public that the operating results of the nationally-owned railway were, when not beclouded with issues and results of the past errors, even, that it is properly organized and properly and efficiently run. It has been so said by the Chief Commissioner of the Board of Transport Commissioners, the C.P.R., and numerous other people. It is efficiently and properly run. Yet at the end of a successful year of railway operations as such, without having had any operating deficit, none the less the report goes out across the land that the C.N.R. has a deficit. Few people understand exactly what the reason is, and the merit of this proposal in one respect is that it removes that for one thing, and it places the nationally-owned road on a basis where the public can see in so far as operations are concerned just how it lines up with the other road.

COMMISSIONER ANGUS: I can see that. Now, the other suggestion is, if in a year like a war year, if there is such a thing again, in an exceptional year of high traffic, you have a big surplus, and the news goes out among the public that you have a big surplus, may that create any repercussions that are shall we say harmful to others?

MR O'DONNELL: We are taking the picture on the

basis of the average over-all year-in-year-out operation. In the twenty-seven years that we have here before the Commission we have had war, we have had recession, we have had depression, we have had inflation -- we have had the whole gamut of economic ups and downs -- and we say, take the position of the Canadian National, extract the war years, extract the depression years or leave them in, take those Tables 1, 2, 3, 4 and 5 in the main brief, compare the operating results, and you end up ordinarily with a deficit of roughly \$20 million. In these last years, by reason of Newfoundland, depreciation accounting and these various other things, Mr. Cooper says the deficit must be in the neighbourhood of \$29 or \$30 million. Now, that is the position we are trying to meet and trying to face and trying to prescribe for.

COMMISSIONER ANGUS: When I asked Mr. Fairweather if he would follow that position to its logical consequence and say that the owners of the railway would be well advised to assume all the fixed charges direct and to try to lease the railways for \$20 million a year, he said, "Oh, no, the future is much brighter than that."

MR O'DONNELL: Now, Dr. Angus, that proposal, of course, I think, Mr. Fairweather had in mind as one that had been submitted on two or three different occasions, it had been weighed, and the Senate Committee that went into that type of proposal turned it down. Sir Edward Beatty presented it and it was a 24 to 1 vote, all parties having gone into that very type of thing. Mr. Fairweather said---

COMMISSIONER ANGUS: I am not suggesting it as a good proposal. I was simply saying, does not the evidence which you have presented and which you have summarized this morning add up to showing that that would be a financially

advantageous proposal? It would have that merit, in the face of its other demerits; the demerits no doubt outweigh the merits, but haven't you, as far as evidence can do it, established that result as a financial proposition?

MR O'DONNELL: As far as evidence can do it, we have said that, bearing in mind that the C.P.R. is to operate, and bearing in mind that it is the consensus of opinion that competition between the two roads is the right and proper thing to have, this proposal that we make is the fair proposal and the best proposal we can devise.

COMMISSIONER ANGUS: When I asked my question just now about Mr. Fairweather's evidence I did not mean that we were discussing whether the proposal was good; I meant whether we were discussing whether or not his evidence has shown that it was financially attractive, and it seemed to me that, placed in that position -- and I hope I was not getting evidence under torture -- Mr. Fairweather then said, "The future is brighter. We do not take quite such a gloomy view of the future. We expect to get more," and so on. Isn't that your recollection?

MR O'DONNELL: You will remember, Dr. Angus, that in the very proposal as submitted, the formal proposal, it is based on the possibility, the potentialities; that very thing was taken into consideration when the proposal was put forward, and it is by reason of the potentialities of the property that something more drastic is not suggested as a remedy. The Canadian National admits that it has possibilities. I read yesterday the section of Mr. Gordon's proposal which summarized the matter; he said:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital."

Now, we might have taken that position fairly and reasonably.

We would have had men who would support that, undoubtedly, among the---

THE CHAIRMAN: Wouldd you read it again?

MR O'DONNELL: Yes, my lord. I am reading from Mr. Gordon's formal proposal:

"It is submitted that by ordinary commercial standards, the entire interest-bearing capital should be converted to equity capital. However, in view of the practical difficulty in the way of converting the interest-bearing capital in the hands of the public into equity capital at this time; and having regard to the potential earnings of the Canadian National System, which are considerable and may in some degree offset the adverse factors here considered; and on the assumption that the present imbalance which exists between railway rates and railway costs will be removed . . ."

Now, the plan is put forward with that very thing in mind, Dr. Angus, I respectfully submit, that there are potentialities there, and that on the average, year in and year out, if this plan be accepted we can hope to achieve the results; and if it were not for the fact that there were potential earnings in the amount that these officers assess, they would undoubtedly, I assume, have come forward with a much more drastic request; but they say -- and Mr. Fairweather has said and Mr. Cooper has said -- "We think our proposal is moderate and modest."

COMMISSIONER ANGUS: If these potential earnings materialize, do you think that they will appear as a surplus, when it might be more comparable, to use the word, that they should appear as a rate of return on a modest equity capital?

MR O'DONNELL: Well, all I would say to that, Dr.

Angus, is that on the evidence the return which we would have -- that is, dollars in the till -- whether it be on a rate of return basis or on a requirements basis as the Board of Transport Commissioners now fix rates -- and they are free to fix them either way -- we would always have less than the C.P.R. I think that is the point to which your question is directed. That is the evidence.

COMMISSIONER ANGUS: I was not thinking of comparing it with them; I was thinking more of what it looked like to railway companies in general. If you had more than your fixed charges you might be paying a dividend, and that would be expressed as so many dollars and cents per share.

MR O'DONNELL: And the directors would have at that time, being faced with earnings, to do what was the reasonable and fair thing to do with them, just as the directors of other railway companies would do with them, whether they would plow back into the property a certain amount, or declare a dividend, or hold it in the treasury.

COMMISSIONER ANGUS: If you declare a dividend, haven't you got so much equity stock there that you are buttering your dividend out very, very thin?

MR O'DONNELL: Well, does it matter in the final analysis if I own all the stock and get all the dividends, or if I say the dividend is a dollar a share on a million shares? It comes to the same thing in the end result, as far as how many dollars I have in my pocket. It doesn't matter how many pieces I cut the apple into, it is still the one apple, and that is all this equity stock amounts to. We have the same equity behind it, whether we divide it into the number of shares that it is proposed to be divided into by the plan or whether we leave it as it is; the same equity is there.

COMMISSIONER ANGUS: From your point of view it does not matter in the least. From the point of the public a very low rate of dividend on a very large mass of stock might look shall we say less like propriety than a rate of dividend per share that compared with that of other railways.

MR O'DONNELL: Well, I don't know.

COMMISSIONER ANGUS: Would that type of comparability be worth having or not?

MR O'DONNELL: Well, I say that in the end result, in so far as earnings that are available are concerned, the owner is the beneficiary.

COMMISSIONER ANGUS: Oh, yes.

MR O'DONNELL: And whether he takes it, if a dividend be declared, on the basis of so much a share on so many shares or on the basis of so much a share on so many more shares, or whether he just gets a lump sum payment, that in the final analysis does not affect him, and I do not think that it affects anybody else.

COMMISSIONER ANGUS: No, but if you follow that line of reasoning this whole recapitalization does not matter very much. I thought that we were bringing in morale, imponderabilities, comparability, what the public would think -- all those various things.

MR O'DONNELL: Approaching it from all possible angles, yes. We think it is the best devisable proposal, and we would only be dealing, in so far as any surplus is concerned, with what there would be left after we paid our fixed charges as they are on the basis of this; and whether that be divided into a smaller or a greater number of shares, I do not think, honestly, Dr. Angus, that that affects the position.

COMMISSIONER ANGUS: At any rate, it is indifferent to you.

MR O'DONNELL: I think so, yes; but the proposal as put forward is not indifferent to me. I say that that is the best solution we can devise.

Now, I simply end up by saying on this point that as far as the Canadian National is concerned, on the basis of the earning power which its officers assess and see and contemplate in the future, we could earn and service the debt, the fixed charge debt, which would result if and when the proposals were put into effect, and I submit in all earnestness that this proposal is the best one we can devise, and it is put forward on that basis, that it will solve the troubles, all those imponderables being taken into consideration, the imbalance in rates and costs and the potentialities for the future and the other item that Mr. Gordon mentioned in the proposal.

Now I wish, my lord and members of the Commission, to turn to another aspect of the matter. We have reviewed what the proposal is, what we think it will do, what results it will achieve, and then, having had our fixed charges adjusted, as we submit, on this basis as fair and reasonable, there is the aspect of maintaining which the Commission is also directed to consider.

Your lordship will remember that 2(c) directs the Commission to

"Review the capital structure of the Canadian National Railway Company and report on the advisability, (or otherwise), of establishing and maintaining the fixed charges of that Company . . ."

So we have to adjust them or study the adjustment, and then you are also asked to consider and study the maintaining of them.

THE CHAIRMAN: Does that word "maintaining" in

your mind imply some sort of variability, some sort of flexibility?

MR O'DONNELL: I think there is flexibility, my lord, but it would be over all to endeavour to keep them on an even keel when once they are properly adjusted. We do not want them to get out of line again and have trouble, and we have therefore put forward, or rather the company has put forward, that other proposal in the plan which is directed to this particular aspect of the problem, and that is the maintaining of the fixed charges. That relates particularly to the matter of future development lines.

Now, the Commission will recall that in addition, as I said, to---

THE CHAIRMAN: That is, your 40 and 60 per cent?

MR O'DONNELL: That type of thing, my lord.

THE CHAIRMAN: And then your own control of whether or not you shall build developmental lines.

MR O'DONNELL: Yes, and those various aspects. So the Commission will recall that in addition to being charged with the duty of reporting upon the advisability of bringing about comparability of fixed charges of the Canadian National with those of other major railways in North America, it was also requested to consider the matter of maintaining the fixed charges in a position of comparability.

In this connection, one further integral part of Mr. Gordon's plan, the company's plan, upon which as yet we have not commented is that regarding the financing of future development lines. It reads -- I quote from volume 98, at page 18387:

"(3) Future development lines should be financed to the extent of not more than 60% by interest-bearing

securities, the balance to be supplied by the Government against the issue by Canadian National of a commensurate amount of equity stock."

Now, Mr. Fairweather explained the purpose of the company's proposal in this respect very clearly. Referring to it, he said (vol. 103, p.19170):

"A. I think that can best be explained this way: it has to do fundamentally with the maintenance, in the future of a reasonable relationship of equity capital of the Canadian National to the funded debt."

THE CHAIRMAN: A reasonable relationship of what?

MR O'DONNELL: Of equity capital of the Canadian National to the funded debt. The proposal to be put into effect and the relationship between the funded debt and the equity will be such as is reflected in Exhibit 245. Now, in order to maintain that and not have it get out of line again, this proposal is advanced.

Then at page 19171 Mr. Fairweather goes on to say:

"If you say, for the sake of argument, that the recommendation contained in the Brief is adopted and if you pursue the same policy⁸ for finding capital for the Canadian National in the future as has been done in the past, you immediately start to upset the balance which you have obtained. And this is one piece of machinery designed to maintain somewhat of a balance.

You see, we normally get all of our capital as interest-bearing debt. And if we get all of our capital as interest-bearing debt, no sooner do we scale it down than we have to put additional capital into the property, and it is no mean figure. I think

it would certainly average \$30 millions a year over a long period.

And in the course of time you would climb into a position where you would once more have an imbalance" -- if all the capital were interest-bearing. He goes on:

"One of the measures here is, that if, in the building of development line - and I believe future developmental lines are going to be necessary in Canada - if provision is made that a reasonable proportion of that cost is provided as equity capital, it would be an automatic safeguard against our funded debt climbing to a point which is unrealistic.

THE CHAIRMAN: Q. Does that mean the Government looking after it?

A. That is all it means. Actually the cost of providing facilities is not going to be changed at all. But it does have the advantage, I submit, that it maintains somewhat of a better balance to our funded debt."

And again at page 19172:

"COMMISSIONER ANGUS: Q. When you say the capital burden is excessive, what you really mean is the funded debt?

A. Yes, that is the point. The language may have been obscure, but the intent was the interest-bearing debt of the Canadian National should be maintained in reasonable proportion, and that unless you adopt some measure like this with regard to the future, you are going to get yourself into a position where you no sooner fix it up than it gets "out of wack", if we have no access to capital except through borrowed funds.

MR O'DONNELL: Q. You must borrow every dollar you put into these lines?

A. We can, of course, use our depreciation reserves, but once we have done that, when we want to use them to buy equipment, they are not available. So it is as broad as it is long."

THE CHAIRMAN: Well, we will adjourn now.

---The Commission adjourned at 1:00 p.m., to meet again at 2:45 p.m.

OTTAWA, ONTARIO
THURSDAY
MAY 25, 1950.

A F T E R N O O N S E S S I O N

ARGUMENT BY MR. O'DONNELL (Cont'd.)

THE CHAIRMAN: Very well, Mr. O'Donnell.

MR. O'DONNELL: May it please the Commission, just at the luncheon adjournment I think I had been speaking of the financing of future development lines and of the proposal which the Canadian National has made in that connection for the purpose of maintaining its fixed charges on a reasonable basis and a better balanced basis once they are adjusted.

Mr. Fairweather referred to and explained the matter more fully when he said in Vol. 109 at page 20045, in part:-

"I mentioned previously that unless some such medium as is suggested with regard to relieving the railway company of a part of the interest burden of its branch lines was worked out, and if we assume that further development lines are going to be necessary in Canada, you will create a situation in which the capital structure of the Canadian National would once more get out of balance. From the standpoint of preserving a reasonable balance between interest-bearing capital and equity capital I think this provision that 40% of the cost of a branch line be provided as equity capital is the minimum.

"MR. O'DONNELL: Q. That is the sub-mission set out at page 51 of the President's statement, paragraph no. 3?

"A. Yes. I note that United States roads have 45% of their capital as equity, and if the Canadian National Railways are to expand it seems to me logical that at least 40% of that expansion capital should be furnished on an interest free basis if your objective is to preserve some sort of reasonable stability and comparability."

Now, later in a reply to a question from Commissioner Angus, Mr. Fairweather said to Dr. Angus at page 20048:-

"Well, as I see it, it all revolves around this. The Canadian National Railways has a horribly unbalanced capital structure, and that is, in the judgment of the management, creating a bad managerial atmosphere. It is the opinion of the management that that situation should be remedied. Now, if it is remedied it must necessarily mean that the Canadian National Railways should only be asked or expected to pay as fixed interest upon investment such an amount as might be reasonable in the light of all the circumstances. Then I say that if you are dealing with an institution such as the Canadian National that has no access to equity capital except through the Government and it has in the past been forced to borrow and pay interest upon every bit of its expansion, you would have a pyramiding

capital structure of the Canadian National even if you adjusted it now to a reasonable basis, and if in the future all of the capital needed for expansion had to be borrowed you would have it once again climbing into a position of unbalance where you would have more fixed interest-bearing burden than the general run of the railway industry.

"I think that is the sum and substance of the matter. It does not mean that 40% which is to be provided interest free should not be expected to earn a return, and I may say this, that in analysing any extensions of the Canadian National the full cost would be taken into account, and the line would be tested by its ability to earn a return on all of the investment. That I think clears up the point."

Now, just in connection with that statement of Mr. Fairweather's, the Commission will remember yesterday that we read, I think, the part of the Canadian National Railways Act concerning the stock. There cannot be any public issues of stock.

Now, Mr. Cooper likewise gave evidence respecting the question of 40% of capital being secured by equity means, and his evidence will be found in Vol. 99 at pages 18521 through to 18523.

Although of course, temporary in nature, the acknowledgement by the Government of an indebtedness to the Canadian National in the amount of \$300 million when drawn upon from time to time as it is proposed, will have the effect of providing moneys which, upon proper approval being obtained from Parliament

for their expenditure, will obviate the necessity of issuing funded securities to the extent of the acknowledgement of indebtedness. This sum, in the absence of the need for capital expenditures greatly in excess of those presently in contemplation will be sufficient to look after the capital requirements of the System for some years to come. Mr. Cooper, you will remember, mentioned that fact.

THE CHAIRMAN: Do I understand then that this \$300 million is to be a diminishing fund?

MR. O'DONNELL: If drawn upon.

THE CHAIRMAN: So that your \$9 million will also diminish - -

MR. O'DONNELL: It will diminish as the capital is used up, and if the capital were used for capital expenditures or for the redemption of obligations in the hands of the public, then it would reduce gradually, but the debt would be reduced proportionately too through the redemption of these securities in that case, or would also be reduced if we did not have to go into the market to borrow money to use for the purpose of the construction of these lines. So that it works both ways. But the \$300 million (and that is why I said it would be temporary in nature) the availability of that money would be temporary in nature, because ultimately it would presumably be used up, and so long as it was not used up the proposal is that we would be entitled at least to the interest on it.

THE CHAIRMAN: So long as it was intact you would get you \$9 million?

MR. O'DONNELL: That is right.

THE CHAIRMAN: When it went down to \$150 million, you would only get \$4½ million?

MR. O'DONNELL: That is right, but if it got down to \$4 $\frac{1}{2}$ million or \$150 million, we would have had the benefit of the other either to pay for the capital expenditures or to have redeemed the obligation upon which we would no longer have to pay interest.

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(Page 24033 follows)

Now, implementation of the company's proposals for recapitalization will have the result, as the Canadian National witnesses said, of accruing to the property in some years some surpluses. The uncontroverted evidence, I submit, has been to the effect that these will not be substantial, but nevertheless it is hoped that there will be some moneys available in the more fruitful years.

While no doubt the directors in the exercise of their discretion will feel that all or some portion of the surpluses earned should be paid over to the Government, it is expected that if the principle enunciated by Mr. Northey Jones, for instance, and Mr. Norman is adopted by the Board, they will retain to come and go on a dollar for each dollar of surplus which is paid over to the Government. That was the principle they enunciated. They thought for a dollar paid there should be a dollar plowed into the property, and that is a matter, after all, for the discretion of the directors; but if that policy, which is a sound one, were adopted, then that is the way any surplus which we might have presumably would be used.

While the company cannot expend those moneys for capital purposes without prior parliamentary approval, the existence of the moneys in the company's treasury would obviate the necessity of selling bonds to the extent to which they are used for capital expenditure as determined upon and authorized by Parliament.

The Commission will remember that under the provisions of the C.N.-C.P. Act we cannot make any capital expenditures without Parliament's consent, so that even if we had moneys in the till that could be used we would have to get the authorization for their use for capital expenditures before we could use them.

Now, the use of moneys accruing from depreciation of equipment will also, to the extent that they are available, contribute to the maintaining of the fixed charges at the level proposed in the company's present submission. However, without providing for some suitable source of funds or for some arrangement to provide the financing of future development lines on a basis whereby a reasonable amount of equity capital is available, the maintaining (using the word in the Order in Council) of the C.N.R.'s fixed charges when once adjusted will be impossible, and soon again they will be out of line and no longer on a basis comparable to those of other major railways in North America.

The adoption of the proposals of the Canadian National, it is submitted, will not only achieve comparability in so far as it is possible to do so on these various tests that can be thought of and which have been put before the Board, but will also provide the means by which there is a reasonable expectation of the company's being able to continue its operation in the future without unduly adding to its funded indebtedness as adjusted. That is the reason for the proposal with respect to the financing of the development lines, that if we were a private corporation we could go into the money markets and issue equity stock if the market were suitable, but inasmuch as we are not allowed to do that, then this proposal is put forward for the purpose of maintaining the adjustment once it is made.

Now I come to the next branch of the discussion which I had set out at the beginning, and that might be generally put this way, as to what has been said against the C.N.R. plan and by whom.

THE CHAIRMAN: Pardon me a moment. On that paragraph 3 you have just been discussing -- I have not a copy

here -- you added a rider to that which is of some importance.

MR O'DONNELL: Yes. You refer to Mr. Gordon's statement that the company would like to exercise or express its views as to whether---

THE CHAIRMAN: Can't you read it?

MR O'DONNELL: Yes; I have to find it.

THE CHAIRMAN: You made it a condition of the whole thing, you see.

MR O'DONNELL: Yes, but I---

THE CHAIRMAN: Unless you want to drop it.

MR O'DONNELL: No, there is no need to drop it, my lord. It is at page 18387 in volume 98. We had quite an extended discussion of that at the time, and possibly I assumed that---

THE CHAIRMAN: No, I do not think we discussed it very much at the time.

MR O'DONNELL: Well, I think we discussed it back and forth.

THE CHAIRMAN: I have been thinking about it since. I would like you to read it again.

MR O'DONNELL: Yes, I will be glad to, my lord. At page 18387, after he had read the proposal concerning future development lines, Mr. Gordon then interjected or said this:

"Mr. Chairman, in saying what I have just said on this particular point I would definitely wish to emphasize and make clear that there is no intention on the part of the Canadian National Railways to undertake the construction of any and all railways which might in the future be suggested, even if 40 per cent of the capital were to be provided by way of equity stock. The Canadian National Railways should

be free to consider on its own merits each individual case of developmental line which might be proposed in the future."

THE CHAIRMAN: Well, you see, the point is this, since you talk about "even if 40 per cent" and so on, that would mean it would be a Government project.

MR O'DONNELL: Well, if it were a Government project -- as I remember, we had that discussion -- if it were a Government project, the Government building a line and handing it over to us for management and operation, then we would not have to provide the financing; that would have been done directly by the Government.

THE CHAIRMAN: Well, that may be an explanation of it. Otherwise it looks rather queer, to have the directors of a company telling its shareholders, "We won't do this for you."

MR O'DONNELL: Well, the Government is free at all times under the Act to build lines or buy lines and entrust them to us, but this is another aspect of the operation where the company itself would be doing the building, and in the past when the company has done any building---

THE CHAIRMAN: Supposing the Government thought it proper for the Canadian National Railways to do a particular piece of building, the Government own all the---

MR O'DONNELL: Well, the Government is in control in the final analysis, there is no question about that, and what would happen to the board of directors I suppose is what would happen to the board of directors of any company that did not agree with its shareholders: there would be a meeting of shareholders and things would be put in the light that the majority of the shareholders wanted them to be put.

THE CHAIRMAN: Well, hadn't a lot of that sort of thing better be left out, because it is a matter that if any case arose would have to be discussed anyhow.

MR O'DONNELL: Well, I think that is quite true; it would have to be discussed.

THE CHAIRMAN: Between the Government and the---

MR O'DONNELL: I think Mr. Gordon was merely wanting to say this, that merely because he was putting forward that proposal he would not wish it to be thought that everybody who came in and suggested that a line should be built---

THE CHAIRMAN: No, it is more than that; it is even if the Government provided the funds. Now, that is not anybody's suggestion. So it would come down to a matter between the Government, which is the owner, the sole owner, of the company's stock and properties, and the management. I doubt the wisdom of making it a part of the---

MR O'DONNELL: I can quite see that, my lord. I think all Mr. Gordon wanted to do was to put himself on record, and he has done that, and the formal proposal simply says that if any future development lines are to be financed it should be to the extent of 40 per cent of the---

THE CHAIRMAN: They would only be financed if the Government consented.

MR O'DONNELL: That is right, no doubt about that.

Then the next branch of the argument, my lord, which I thought I might speak of was, having reviewed the plan and having seen what the plan in the estimation of the company will do, and the effect which it should produce, I now propose to see what has been said against the plan and by whom.

THE CHAIRMAN: Didn't you say a while ago that

nobody had any right to say anything?

MR O'DONNELL: Well, when I said that, my lord, I may possibly have been misunderstood. I would not for one minute want---

THE CHAIRMAN: I am not insisting on it.

MR O'DONNELL: I would not want for a minute that you should think that I was suggesting that my friends the C.P.R. were not entitled to come in and make---

THE CHAIRMAN: We hear things said against the plan, and we are probably going to listen to more things said against it.

MR O'DONNELL: Undoubtedly, and under that reserve that is the situation.

I am just now going to say what has been said as at this date at least, and, with the foregoing in mind, I would like to review briefly what has been said against the Canadian National proposal and by whom.

To begin with, the provinces, I submit, have said nothing against the proposals. In fact they, I think, have each in turn supported it in principle. They have said, "Well, we don't know enough about the details to go into any study," but they have not been against the plan.

The only party before the Commission which has intimated that the Canadian National proposal should be considered with caution -- put it that way -- by reason of possible harm which it fears might result to it, is the Canadian Pacific Railway.

(Page 24039 follows)

Throughout the record the Canadian Pacific Railway have protested that they have no objection to the capital structure of the Canadian National being adjusted provided they are afforded protection against a fear which they, in my view, in their imagination have unwarrantedly created. It is significant, I think, to note that no witness with any railway experience or actual knowledge as to railway operations and particularly with railway operations in so far as the Canadian National is concerned was called by the Canadian Pacific. They had recourse to outside persons who, while they may have experience in certain fields, in my submission and with deference, certainly knew nothing of and pretended to know nothing about the operations of the Canadian National Railways.

So that the position may be brought into proper focus, I propose to review briefly the record as it stands concerning the views which these gentlemen - Mr. Northey Jones, Mr. Norman and Mr. Elliott expressed.

Mr. Northey Jones was the first gentleman called by the Canadian Pacific Railway and I propose to refer to excerpts from his evidence and make such comments as I consider related. Mr. Northey Jones testified in Volume 111, page 20114 that he had been asked by the Canadian Pacific to express his views as an investment banker with regard to the Canadian National's recapitalization plan in respect of two points - firstly, as to its effect on the Canadian Pacific and, secondly, if upon being capitalized on the basis proposed the net earnings of the Canadian National, after providing for interest on the reduced basis, are not required to be used to pay a return on the equity capital. Those were the two points which he was asked to comment upon.

Now, Mr. Northey Jones said earlier in his submission that it was difficult to oppose recapitalization of an

enterprise with regulated rates to bring it into line with proper valuation of the property (Vol. 111, page 20415) - that due consideration to earning power past, present and prospective and to other relative facts would have to be given.

Now, as I remember it, anything which Mr. Northey Jones may have said against the Canadian National's proposal can be summarized as follows: he warned against scaling down the capital structure before very careful study; secondly, he expressed fears that if there was too drastic a scaling down, it might result in the Canadian National having surpluses and he spoke of surpluses even as extensive as \$60 million after paying \$15 million net charges on the railroad's net debt and, thirdly, theoretically that if the Canadian National had surpluses he feared the situation might arise where it might restrict the Canadian Pacific in applying for a rate increase and make its own rates.

Now, broadly speaking, these were Mr. Northey Jones' fears. Now, let us look at these in turn. Firstly, as to study before scaling down. He said that that should be done. I simply say to the Commission and ask the Commission what more careful studies can it be suggested should be made than these which have been explained in detail by the most competent and qualified persons available as far as the Canadian National is concerned -- Mr. Cooper, Mr. Fairweather and Mr. Gordon. Secondly, as to Mr. Northey Jones' fears re surpluses -- on the record, I respectfully submit, he is not in a position to bring, nor did he attempt to bring evidence of any weight concerning the possibility of surpluses. He has not inspected the Canadian National Railways, nor is he in any way familiar with its operations. His statements in this respect take him right out of the play, so to speak.

He made no studies (Volume 113, page 20595) and

the particular figures used by him as to the possibility of the Canadian National surpluses are, on his own admission, purely speculative and supposititious.

He assumed (volume 112, page 20446) that if the Canadian Pacific Railway is to remain the standard ⁱⁿ rate matters and rates are set so that the Canadian Pacific Railway can earn after income tax an amount somewhere between \$47,500,000 and \$66,600,000 then, I quote:

...in my opinion (Mr. Northey Jones' opinion) the minimum wage necessary to attract new ^{equity} capital to the enterprise it seems reasonable to suppose that the Canadian National with its larger system and greater gross revenues, should earn at least \$50,000,000 a year before income tax."

He was cross examined by Mr. Covert, page 20504 and Mr. Covert said:

"Now, I just wanted to check with you on that as to how you arrive at that figure. Did you say, assuming rates were such that they gave the Canadian Pacific Railway a return of 6-2/3%, that would give the Canadian National Railways gross at least of \$50,000,000? Does that mean \$50,000,000 available for fixed charges? "

And again:

"Q. Now, could you tell us just roughly how you arrived at that figure?

A. Well, I think it would be rough. From \$500,000,000 of gross revenues of the Canadian National, to earn that \$50,000,000 (the transcript there is in error in saying \$500,000,000 --) to earn that \$50,000,000 would be earning just 10% of gross, which would mean an overall expense ratio of 90% and it would seem to me that there

"ought to be some -- that that is not out of line to think of a railroad being able to operate on a 90% expense ratio. I mean, that is one rough way of checking the figure of \$50,000,000."

Well, I submit that it is rough indeed, and that it is in no way related to reality, and, on that score, I point to Exhibit 254 and to the fact that the operating ratios as there set out on page 41 show that in 1948 the ratio was 94.6%. That is an error of 5% and that in 1949 they show 95.56 which is about $5\frac{1}{2}\%$ error and that runs into about \$27,500,000.

Now, I submit respectfully and with deference to Mr. Northey Jones that what he said as to the figures was nothing but a hazarded guess or was in direct conflict with the evidence of Mr. Cooper and Mr. Fairweather.

Now, during the course of my cross examination of Mr. Northey Jones, page 20587, he was referred to the figures \$47,500,000 and \$66,600,000 used by him in his formal statement at page 20446. The evidence is as follows:

"Q. And all this is supposititious and merely for the purpose of illustration?

A. Correct.

Q. It is preceded by the word 'if' as many of your proposals and suggestions are throughout. It is purely argumentative and illustrative?

A. That is right."

And at page 20594, referring to the further figures used by him in his formal statement at pages 20447 and 20448 -- the figures of \$35,000,000 and \$60,000,000: "it is a supposition, I take it." , in reply to my question:

"Again you have not pursued this supposition,

"and you are putting it forward for the purpose of illustrating your argument."

And Mr. Northey Jones replied:

"That is correct."

Mr. O'Donnell went on to say:

"That is, of course, a figure of \$50,000,000 on \$500,000,000 of gross revenues, and it would mean that the operating expenses would consume 90% and that there would be 10% left over."

I had just pointed out that there is not any 10% left over in 1948 and 1949 on the figures:

"Q. That is a rough rule of thumb calculation but not based on any study that you have made?

A. No.

Q. Then, please tell me if you have made any study -- I assume you have not -- in arriving at that figure of \$35,000,000?

A. The figure of \$35,000,000 is a derivative from the \$50 million.

Q. Again it is made simply as a matter of arithmetic and without any study of the details?

A. Without any study of the details but with some estimation of or some consideration of what the growth in traffic in Canada may be, and some consideration of what economies and savings may be, and some consideration of what may result from rates which have been asked for.

Q. With respect to growth of traffic in Canada, I think you said very fairly and frankly that in so far as the Canadian National is concerned, you are prepared to leave that to the judgment of the officers of the Canadian National who have full information and details concerning that?

A. Yes."

(Page 24045 follows)

Now, how unrealistic and, with deference again, useless, is such a rough computation and a rough rule-of-thumb calculation, not based on any study, can, I submit, be readily be seen when one glances at the figures shown in the income account, Exhibit 245, page 6, and when one considers the evidence of Mr. Cooper and Mr. Fairweather who speak with the full knowledge and understanding of the facts and the details in play in such computations as have been referred to by Mr. Northey Jones.

I say that his "fears" as to possible surpluses are predicated on no valid foundation, that it must be regarded as sheer speculation. Obviously he has no real knowledge of the extent of Canadian National's operations traffic-wise, railway-wise or otherwise. Mr. Northey Jones made "no particular study of the Canadian National with respect to either its capitalization or the value of its property" (page 20460). Presumably in an endeavour to infer that he had some knowledge of Canadian National Railways, he made reference to his having come into contact with it ^{as an} active asset, I think he said, of the Dominion Government when considering a Dominion bond issue. That is at page 20452, but he frankly stated under cross-examination that the recapitalization of the Canadian National as such "never came up at that time" and that no consideration was given whether it should be recapitalized or written down. That is on the same page.

Now, regarding the registration of Dominion Government securities for sale in the United States, when Mr. MacPherson put it to him that

:.....having regard to the fact that
Canada as a nation was on the note you are

not as much concerned with the capital structure of the Canadian National System as otherwise you might be."

He replied:

"A. 'That is correct."

That is page 20515.

Now, a number of times during his cross-examination by Mr. Covert he was asked if he had made any study of the capitalization of the C.N.R. or of its property as to the proper method of determining the capital structure of the Canadian National. Several times he was asked this question. The following answer given to Mr. Covert at page 20463 may be, I submit again with deference, by way of an excuse for his not having made such studies. He said:-

"Well, I think it would be rather presumptuous for somebody from the United States to say what he thought the Canadian Government and the people of Canada should say was a fair return on capital which they have invested in this great national enterprise."

His failure, I submit, to have gone into the matter more thoroughly is pointed up by the following question and answer at page 20491 where Dr. Innis asked this question:-

"Q. Would you care to say how much you think the capital should be reduced, or how far you go with it?

"A. I think that is very hard, Dr. Innis, unless you make a specific study."

I think that was a fair enough answer. He had not made any

such study, and his position in this respect is in direct contrast, I say, with that of Messrs. Cooper and Fairweather. It is not unfair to suggest, by way of summarizing his evidence, that he made no contribution whatsoever towards enlightening the Commission as to what the recapitalization of the Canadian National should be.

Now, the only positive evidence on that subject of surpluses of any reliable weight, I submit, is that again by Mr. Cooper and Mr. Fairweather. Their evidence has already been commented upon and I will not take time to refer to it again at this point.

Now, as to the third fear expressed by Mr. Northey Jones, that if the Canadian National had surpluses it might not join the C.P.R. in applying for a rate increase were such an increase necessary: I say this fear is equally unfounded. Whether the Canadian Pacific joins the Canadian National or vice versa, either railway is entitled to apply for a rate increase, the circumstances justifying it. It is the duty of the Board of Transport Commissioners to see to it that just and reasonable rates prevail in Canada for all railways under its jurisdiction and at all times, and notwithstanding any views which the Canadian National might have at any time in this connection, the Canadian Pacific would be in a position to present its case and vice versa, and we are satisfied that the Board, the circumstances justifying it, would, in the exercise of its duty, accord full justice to the Canadian Pacific or the Canadian National as the case might be. I submit that this fear is again unfounded. Moreover, now, in my respectful submission, the fears of the C.P.R. expressed through Mr. Northey Jones in its desire for protection, are matters

wholly irrelevant so far as the present reference is concerned; and as and when in the unlikely and remote future the Canadian Pacific might be adversely prejudiced or harmed by any adjustment of the Canadian National's capital structure (and this could only be through the aspect of making rates) it will be time enough for it then to make its complaint in the proper quarter, either before the Board of Transport Commissioners or Parliament itself.

Now, on the other hand Mr. Northey Jones, it is quite clear I think from his testimony, was of the view that the Canadian National is entitled to an adjustment of its capital structure. I put it this way. He was not in any position to prescribe the medicine, although he knew the patient was ill. He had only to look at him to know that. He could not prescribe what he needed to get well, but he did know he was ill. One has but to read his evidence to be impressed with this fact. He agreed, I submit, that the Canadian National is entitled to an adjustment of its capital structure. Let me refer briefly to some of his statements, for instance, in Vol. 111 at page 20419, where Mr. Northey Jones bluntly admits that if an investment banker were advising a commercial enterprise:-

".....as to the proportions of capital that should be represented by fixed interest securities (and I emphasize the word 'fixed'), he certainly would not recommend as great a proportion of fixed interest securities as is the case now with the Canadian National Railways".

Now, that is exactly the Canadian National's proposal here and the Canadian National's request for adjustment,

the adjustment due to that. He would not recommend as great a proportion of fixed interest securities as is the case now with Canadian National. He didn't know how much, but he certainly would not recommend what there was.

At page 20487 of Vol. 112, he said, in part:-

"I agree" (and he is being examined by Mr. Covert)

"...that there should be a recapitalization of the Canadian National. That is, it is not maybe for a person from the United States to say so, but I mean from the financial point of view the fixed interest charge and the \$1.3 billion is large, and I would have no hesitancy in saying that if I were in the position of the Canadian National I would want a recapitalization; but I am here appearing for the Canadian Pacific, and all I am saying is that if there is to be a recapitalization I would hope that it would result in such a fashion that the credit of the Canadian Pacific is not hurt thereby."

And at pages 20489-90 of Vol. 112 he further said to Mr. Covert:-

"Q. Now, you did say that you agreed that the Canadian National should in your view be recapitalized?

"A. Yes.

"Q. That is for two reasons, I assume, sir: one, you say that the interest on their funded debt is too great based on their earning power. Is that one reason?

"A. I would say that based on their past and present earning power it would seem that the present fixed charges - -" Then there are five or six lines that I think have no bearing.

"- - the charges on the \$1.3 billion, some part of them ought to be taken care of in some other way."

The intervening lines I will read if the Commission thinks I should. I am not interested in them anyway. Then he went on to say further in the same page:-

".....I can perfectly understand the management's position in the Canadian National, and mine would be the same, that I would want my debt and my charges reduced, but I think that there you come -- and I think the position of the Canadian Pacific has been that they were not objecting at all to a recapitalization of the Canadian National that would reduce its fixed interest-bearing debt providing that there was something done which would protect the Canadian Pacific, and I do not know just how you are going to work that out. That may mean that there is some way of providing that there will be some return to the equity holder in the Canadian National, the same way as there is some return to the equity holder in the Canadian Pacific.

"Q. Now, you are aware, Mr. Northey Jones, that every time the year ends and the Canadian National shows a deficit that

is headlined in the press throughout the country, and that the probabilities are that people in the country do not understand the funded debt position of the Canadian National?

"A. Right.

"Q. And you would agree that that probably would affect the morale of the employees of the Canadian National -- would you agree with that?

"A. Well, I certainly think it would have an affect upon the morale. I know I would not want to see recurring deficits in a company in which I was one of the managers."

That is the part I am interested in. Again, in reply to Mr. Frawley at page 20557 of Vol. 113:-

"Q. Mr. Northey Jones, you agree in a general way that there must be some recapitalization of the Canadian National?

"A. I would say so, yes, sir.

"Q. And you, of course, have not applied your mind to that problem extensively enough to recommend perhaps just what should be done in detail?

"A. That is correct, sir.

"Q. The principal objective would appear to be that the fixed charges must come down?

"A. As expressed in the Canadian National plan, yes."

And at page 20573:(by Mr. Frawley again):_

"Q. So there is question about getting any good to the Canadian people out of rehabilitating the Canadian National, either directly or indirectly?

"A. Wait a minute. You asked me about the effect on Canadian Pacific which is really what I am here to speak about.

"Q. Yes.

"A. Now you jump over and say that there is no good at all to the Canadian people from recapitalization of the Canadian National. That jump I would not take, no. I think there is some good to be obtained. I think that it is reasonable that the Canadian National should have a recapitalization plan."

Now, I have only pointed to the parts of Mr. Northey Jones' evidence that were pertinent to what I am discussing. He testified at some considerable length, but I conclude by saying that he really did not prescribe anything as a remedy for the situation, although he was invited to do so.

Now, Mr. Norman was the next witness who was called by the Canadian Pacific, and with the permission of the Commission I propose to deal briefly with his evidence as I did with that of Mr. Northey Jones. Mr. Norman's evidence will be found commencing at page 20609. Mr. Norman's views were very conveniently summarized by him and will be found in Vol. 113 at pages 20642-3. He had his views summarized under five headings, and I think I might just read those. He began by saying:-

"My views may be summarized as follows:- (this is at the end of his formal submission):-

"(1) That the imbalance between revenues and the increased costs of labour and materials should be lessened as much as possible by further freight rate increases.

"(2) That \$391 million of interest-bearing obligations held by the Government which were issued in connection with the repatriation from the United Kingdom of C.N.R. securities, should be exchanged for income bonds in accordance with the suggestion from Mr. R. C. Vaughan and so reflected in the balance sheet.

"(3) That the acknowledgment of an indebtedness by the Government to the C.N.R. of \$300 million should not be considered.

"(4) That future development lines, other than those created for national policy reasons, should, like all other additions and betterments, be financed in the normal commercial manner, and those created for national policy reasons financed entirely at Government expense and their operations segregated as a Government enterprise until they become commercially sound or become an integral part of the System.

"(5) That a portion of surplus earnings, after payment of interest fixed and contingent, should be retained to provide funds for improvements and betterments and the balance paid to the Government as a return on its equity capital."

Now let us examine Mr. Norman's first point:

"That the imbalance between revenues and the increased costs of labour and materials should be lessened as much as possible by further freight rate increases."

In connection with that, there is no disagreement between us. We agree that the imbalance between revenues and costs should be adjusted. It is the function of the Board of Transport Commissioners, and we have faith that the Board will carry out its function in this respect.

In any event, the Commission will have in mind that the C.N.R. proposal as put before it by Mr. Gordon is expressly predicated "on the assumption that the present imbalance which exists between railway rates and railway costs will be removed by adequate rate increases" (Vol. 98, p. 18387).

In the C.N.R.'s proposal, Mr. Norman's first point has been expressly taken into consideration.

Mr. Norman's second point reads:

"That \$391 million of interest-bearing obligations held by the Government, which were issued in connection with the repatriation from the United Kingdom of C.N.R. securities, should be exchanged for income bonds in accordance with the suggestion of Mr. R. C. Vaughan and so reflected in the balance sheet."

On the record, what evidence is there to support or explain Mr. Norman's selection at this time of the figure of \$391 million of interest-bearing securities?

It is in no way related to any reliable computation or study by him -- he made none -- of the extent of the relief needed by the Canadian National Railways. The figure of \$391 million mentioned by Mr. Norman stands as

purely an arbitrarily selected figure, in no way related to the extent of the claim that is advanced. It is a mere grasp at a figure mentioned some years ago under different circumstances, in my submission, with other problems in mind and with another purpose in view.

The only inkling as to the reason for his selection of this amount is his reference to a suggestion made by Mr. Vaughan in the House of Commons Committee in May 1946 (Vol. 113, p. 20642).

As was pointed out when Mr. Norman referred to this matter, it was nothing other than a tentative proposal as to a possible settlement of a mere portion of the problem as it now stands before the Commission. (Vol. 114, p. 20795-96). It related to a particular parcel of securities of the railway which the Government had in its possession at that time. That is four, going on five, years ago now.

Mr. Vaughan's proposal was not acted upon. Meanwhile the bigger and broader problem has been made the subject of reference to this Commission and the approach to the problem is now on the over-all basis for which Mr. Norman's suggestions provide no adequate solution of the real problem.

Mr. Norman's third point was:

"That the acknowledgment of an indebtedness by the Government to the C.N.R. of \$300,000,000 should not be considered."

As to Mr. Norman's reasons for suggesting that the Government should not agree to the proposal referred to in this point, it seems obvious that he did not understand the proposal of the Canadian National. Mr. Norman chose to suggest that this acknowledgment was nothing but a "subsidy", and a "hidden" subsidy at that, which would

provide new money to the Canadian National.

He completely overlooked, in my submission, the proposal which is that excessive capital burden totalling \$1,533 million, entailing the payment annually of unjustifiable interest charges, and the bearing of unjustifiable expenses, was to be settled on a compromise basis whereby the Government would dispose of and settle the \$1,533 million claim of the railway for \$1,060 million, the \$1,060 million to be provided, as we have explained.

Now, the \$300 million is, of course, of that amount only because it represents the difference between the settlement price really of \$1,060 million and the amount of railway interest-bearing securities held by the Government. It is part of a lump sum figure in an over-all compromise settlement of a much larger claim which he obviously has not evaluated.

On the record, referring to the claim, Mr. Norman stated -- and I quote his words -- "I have not attempted to deal with these factors" (i.e., "the excessive capital burden of \$1,533 million on various hypotheses"). (Vol. 113, p. 20628).

His reasons for not making any study are quite immaterial, in my respectful submission. The blunt fact is that he did not do so; and yet quite arbitrarily he rejects this integral part of the proposal of settlement without having examined its make-up in any way.

As to his fourth point:

"That future development lines, other than those created for national policy reasons should, like all other additions and betterments, be financed in the normal commercial manner, and those created for national policy reasons financed entirely at Government expense and their operations segregated as a government

enterprise until they become commercially sound or become an integral part of the system."

That was his fourth point. This point relates presumably to that portion of the Canadian National proposal dealing with future development lines. Mr. Norman has chosen to divide these into two categories -- those created for national policy reasons, to be financed according to his proposal entirely at Government expense, and all others which he suggests "should be financed in the normal commercial manner."

We have no disagreement concerning Mr. Norman's proposals as to the financing of national development lines created for policy reasons. The short answer to his suggestion is that the Government has not seen fit to acquiesce in this procedure. So long as Government policy remains as it is, Mr. Norman's suggestion is impracticable.

In the face of the statute presently governing the Canadian National Railways, it is difficult to see how the railway could "be financed in the normal commercial manner" suggested by Mr. Norman (which is presumably by offering shares to the public) by reason of the fact that the sale of its capital stock, its equity shares, is expressly restricted to purchases by the Government. Section 5 of the Canadian National Railways Act reads:

"5. The Governor in Council may declare that the Company shall have a capital stock, with or without shares, to such amount as may from time to time be deemed expedient.

(2) All such stock shall, until otherwise ordered by the Governor in Council, be vested in the Minister of Finance on behalf of His Majesty.

1919, c. 13, s. 3."

And as you, Mr. Chairman, mentioned yesterday, the

Governor in Council has not, in so far as I know, seen fit to order otherwise than that.

Moreover, the Commission will have in mind the discussion which developed between Mr. Norman and Dr. Innis and Dr. Angus when this proposal was being put forth, as to which lines would be considered as national policy lines and which would be regarded as, or justified from a "business or commercial viewpoint." (Vol. 113, p. 20630). Commissioner Innis at p. 20665 said:

"It would seem to me very difficult for the Canadian National to draw the line, when there was a prospect of having to operate say at 5 per cent from a commercial point of view and 3 per cent from a national point of view?"

And in reply to Dr. Angus' question, at p. 20666:

"COMMISSIONER ANGUS: Q. If a mistake were made in the classification, would you correct it, in the light of experience? I mean, if a railway were classified as fully justified and turned out not to be fully justified.

A. No; I think that the risk is taken at the time, like any other commercial enterprise. I think you take that risk and you stand by it. If you lose you lose. I do not think you can have two bites at the same cherry."

And at page 20667 the following question by the learned Chairman and answer by Mr. Norman, again emphasize the difficulty of endeavouring to handle the matter on the basis suggested by Mr. Norman:

"Q. . . . Could you apply this system of yours with the same facility to the other lines that have been taken over?

A. Not if they become a part of the system itself."

Mr. Norman's proposal, I submit, my lord and members of the Commission, is impractical and unworkable, and we leave it at that, with this further statement, that it entirely overlooks the reason underlying this part of the Canadian National's submission.

Mr. Norman's proposal otherwise entirely omitted to deal with this very important aspect of the direction to the Commission, i.e., the maintaining of the fixed charges when once adjusted.

The Canadian National proposal as to the financing of future development lines was intended, as I said this morning, as a means of "maintaining" the fixed charges of that company on a basis comparable to that of other major railways in North America in the future, after the implementation of the adjustment which is proposed by the plan.

Now as to the last point mentioned in his formal submission:

"That a portion of surplus earnings, after payment of interest fixed and contingent, should be retained to provide funds for improvements and betterments and the balance paid to the government as a return on its equity capital."

This is a matter for the Board of Directors. The proportion to be retained and the payment to be made of surplus earnings is something which the Directors of the C.P.R. decide, and is something which in our respectful submission can also safely be left with the C.N.R. Directors to decide. The shareholders of both companies are, in the final analysis, in control of this situation. The Directors of both companies are responsible to their respective shareholders as to their dividend policy, if and when earnings available for dividends have been made.

It must be assumed that they will use their business judgment in handling matters such as those referred to in this last point mentioned by Mr. Norman. Under the statutes as they stand today the two Boards of Directors are equally free to deal with any surplus earnings that may accrue.

Incidentally, during the war years, the only years when there have been surpluses, the C.N.R.'s handling of the matter was its own affair.

It did not, however, in the process cause the C.P.R. any "harm". The latter survived its fears, if any it had, of the use the C.N.R. might make of the surpluses in those years, as we are satisfied they will in the future, even if the situation might arise where the C.N.R. had some surpluses. The surpluses during the war years were paid to the Government. There is no bar or prohibition against any such payment. Both C.N.R. and C.P.R. are on the same footing in this respect.

As to what might be done in the circumstances where surpluses were available to be disposed of, let me quote the evidence of Mr. Fairweather (Vol. 111, p. 20342):

"I think that would be a matter first in the discretion of the Board of Directors of the Canadian National, and secondly a matter of concern to the shareholder. You can hardly expect me to say what might happen in some hypothetical situation that I cannot see as probable although I say it is conceivable. I think it would be a conceivable idea that if such a surplus did exist" --

they were speaking there of surplus in the extent of \$50 million --

"it would be a reasonable matter for consideration of the Board of Directors of the Canadian National

Railways to turn over some of it to the Government, and if they did not elect to do so I consider it conceivable that the shareholder would say to them, 'Now, we are not satisfied with the way you are dealing with this thing and we will have something to say about it in our annual meeting.'

The situation would be handled by the C.N.R. Directors with the same freedom for the exercise of their business judgment in fulfilment of their duty, as the Directors of the C.P.R. handle a like situation.

Now, apart from the five points which were listed in the summary of Mr. Norman's views concerning the proposal to recapitalize the Canadian National, during the course of his testimony Mr. Norman expressed certain "fear" on the part of the Canadian Pacific as to harm which might result to it if the recapitalization proposals were carried through.

For instance, in the formal statement which he read at the outset of his testimony (and which I take it we can agree had, to say the least, the "imprimatur" of the Canadian Pacific), he quoted Section 114 of the Duff Report containing a reference to the aggressive and uncontrolled competition which prevailed during the 1920's. In this quotation one finds a statement that "one of these competitors was backed by the long purse of the state." It will be remembered that the condition of affairs being referred to in the Duff Report was that which existed prior to the passing of the C.N.-C.P. Act in 1933, following upon the report of the Commission. Mr. Norman's "fear" was that the proposed recapitalization would place a large sum at the disposal of the government-owned railway.

At this point in his cross-examination even, I submit, he had so completely misunderstood the C.N.R.'s

proposal that he was obviously under the impression that \$300 million was to be placed on deposit to be drawn on at will. He said:

"I understood they are going to put it on deposit."

(Vol. 114, p. 20771).

When challenged that the inference in his reference to the above mentioned extract from the Duff Report ("backed by the long purse of the state") was, "so far as our Canadian Pacific friends are concerned, that such competition, unwarranted, would again take place," he said (Vol. 114, p. 20760-61)

"A. Well, my inference there, sir, is that conditions might easily arise where the Canadian National would have funds to go ahead with capital expenditures of this character, when the Canadian Pacific would not be in that position because of the difficulties of raising money in difficult times."

(Page 24063 follows)

Now, Mr. Norman was evidently at that point quite oblivious of the terms of the Canadian National-Canadian Pacific Act, which it was indicated to him, had been enacted for the very purpose of preventing unwarranted and reckless competition.

The following excerpts from the transcript are enlightening - Volume 114, Page 20761:

"THE CHAIRMAN: It (referring to the C.N.-C.P. Act) is of some importance. Does either of you gentlemen interpret that Act as carrying any restraint upon your building new lines or acquiring new lines?

MR. O'DONNELL: We do, yes, my lord.

MR. EVANS: I have no doubt that that would be intended to prevent a wholesale competition between two companies; but the point that is -

THE CHAIRMAN: That is, all kinds of competition, including the acquisition of new lines and the building of new lines.

MR. EVANS: I would think so."

Mr. Norman's "fears" that the Canadian National Railways might have money to go ahead with development lines when the Canadian Pacific would not be in that position, are thoroughly unfounded. Moreover, the provision of Section 21 of the Canadian National Railways Act, placed such matters entirely under the control of Parliament -

THE CHAIRMAN: Would you repeat that?

MR. O'DONNELL: Moreover, the provision of Section 21 of the Canadian National Railways Act, placed such matters entirely under the control of Parliament, without whose approval no monies can be spent on this type of capital expenditure.

In this respect, I would refer you to Pages 20762-

63-64 and the matter was summarized on Page 20765 by me when I said to the Chairman:

".....my whole point is that before we could build that line we had to go to Parliament, and under Section 21 we have to get the expenditure approved. Now, that being the case, what danger is there? - because Parliament, after all, is in control, and our friends are free to go there and have their representations made, either through members or in the Committee, and they have done it and do it constantly."

We were referring there to one of these typical lines - the Barraute line.

I further said on Page 20766 regarding unwarranted competition in the building of new lines:

"The building (and I am referring there to new lines) particularly is what they refer to in that paragraph 114 (of the Duff Report) and I say since that report in paragraph 114 the Canadian National-Canadian Pacific Act was put on the statute books, and the fears of my friends are not warranted. I further point to the Canadian National Railways Act, and my friend says he does not like the provision of Section 21, that it provides something that the Canadian Pacific has not got, but I point to the fact that it has been on the statute books since 1919, and they have had plenty of time in the interval to have it amended if it were improper. And I say that under that Act, under that Section -

MR. EVANS: I did not say it was improper.

MR. O'DONNELL: Well, you complain that it is unfair to your line.

MR. EVANS: No....."

and then he goes on to some other remark.

Obviously, I say, this "fear" missed fire - it was unfounded. We cannot build without Parliament's permission and approval and Parliament is in control. Now, notwithstanding that the transcript goes on to show that when I assumed or hoped that we had convinced Mr. Norman that insofar as development lines were concerned there was nothing to fear, right after a short recess he came back in the box and the transcript reads at Page 20768 - after I was about to lead him onto another matter he asked if he might advert to the matter we had under discussion just before the recess and the transcript reads in part as follows:

"....Now, I (Mr. Norman) have expressed the fear here, and my fear is that in time of distress - which may come; you never can tell - if you are in a position of having moneys you can make additions to properties, but not necessarily lines; you might order new diesel engines, you might add astral domes to the tops of your cars, and all sorts of things, which the C.P.R. having to go out in the open markets for their capital would not have the funds necessary to do."

I said to him:

"Q. That is what you have in mind?

A. That is what I have in mind.

Q. Then what I point out to you by way of meeting that fear or dispelling that fear is that the Canadian National even though it had moneys would have to go to Parliament with a

budget and have the approval of the expenditure made before it could be done; now, are you aware of that?

THE CHAIRMAN: Mr. O'Donnell, would that apply to all capital expenditures?

MR. O'DONNELL: Yes, my lord."

The "fears" as expressed by Mr. Norman are equally as unfounded concerning "new diesel engines"... "astral dome tops...and all sorts of things" as were their unwarranted fears concerning the building of branch lines.

The matter was discussed in some detail on page 20770 and following. I pointed out that the fetters which were put on the Canadian National as a result of what had happened in the 20's were still there; that the Canadian National Railways had not and was not asking to have them removed; that under the statutes which apply to the Canadian National Railways -

".....we could not spend any portion of the \$300 million under that section of the Act which I have just read either for capital expenditure or retirement of securities or any other way without having had the budget approved by Parliament. In those circumstances I cannot for the life of me see what the fear is".

That is at Page 20770 and following. I respectfully say that there is no fear in this case but the fear itself and it is quite unwarranted.

Now, a further "fear" of hurt to come to the Canadian Pacific Railway, speculative and unfounded, solemnly put forth, in my submission, as an excuse for denying to the Canadian National Railway an adjustment of its capital structure, is set out in Mr. Norman's remarks at page 20727 of Volume 114 where he said in part:

".....I say there is quite a definite cause for alarm that if the Canadian National end up with substantial surpluses in the one case, if they have a free pocket of money to do as they see fit with, that must bring about a condition which must cause alarm to the C.P.R."

True, Mr. Norman prefaced this particular remark with the words "I cannot speak for the C.P.R." but I ask, on whose behalf then he is speaking, called as he was by it as a witness?

Now, I like to use straight language but the picture of the Canadian National Railways having "a free pocket of money to do as they see fit with" as being "a condition which must cause alarm to the C.P.R." is, under the law, quite impossible. The safeguards for the protection of the C.P.R. against the making of capital expenditures by the Canadian National Railways, we have already discussed. Parliament is in control of these throughout. Surely the Canadian Pacific Railway will have faith in Parliament?

In the light of the statutes on the books, these fears are unfounded. They constitute no reason for denying the Canadian National Railway's request for an adjustment, and they constitute no reason for suggesting that the proposals which have been put forward by the Canadian National should not be acceded to.

Now, there was one other "fear" Mr. Norman put forward on behalf of the Canadian Pacific Railway and that was in an endeavour to have the Commission consider the Canadian National Railway's proposal for readjustment as something other than the really simple matter which it really is when one gets down to the practical aspect of it. There was a reference there to the Drayton-Acworth Report in 1917 in Mr. Norman's statement which will be found at page 20611.

Now, the Commissioners there, the Drayton-Acworth Commissioners, were referring to a situation existing prior to, and in 1917. It refers to competition with the Canadian Pacific Railway which was then provided by the Canadian Government Railways, and the possibility of rate reductions by the latter in competition with the Canadian Pacific Railway which would force it to follow reductions "made by the Government Railways on pain of losing the business entirely." Those words I have just mentioned are the closing words of the extract from Page 45 of the Drayton-Acworth Commission which Mr. Norman referred to at page 20611.

I submit that this extract is quoted presumably to draw an inference for the purpose of disturbing the minds of this Commission that such danger could arise today. I suggest that it would have been well also to have quoted the express recommendation in the Drayton-Acworth Report, No. 35. No. 35 reads:

"We recommend that the authority of the
Railway Commission be extended to include the
Dominion Railway Companies System."

This latter recommendation was adopted.

THE CHAIRMAN: Which Commission was that?

MR. O'DONNELL: The Drayton-Acworth Commission, my lord. That suggestion was adopted. The authority of the Railway Commission was extended and its functions as recommended by Recommendation No. 54 were enlarged to have jurisdiction over all Dominion Railways.

THE CHAIRMAN: The Railway Commission to which you refer is the Commission which managed Government railways?

MR. O'DONNELL: No, my lord, it is the predecessor of the Board of Transport Commissions. At that time it was known as the Board of Railway Commissioners.

THE CHAIRMAN: What is this that you describe as being there?

MR. O'DONNELL: - "We recommend that the authority of the Railway Commission be extended to include the Dominion Railway Companies System." And I am suggesting to you, my lord -

THE CHAIRMAN: Up to that time they had not the authority?

MR. O'DONNELL: No, not over the Government railways and what the Drayton-Acworth Commissioners were saying was that it was that it was possible under that set-up whereby the Department of Transport operated the Government Railways for them to cut rates that the Canadian Pacific Railway would have to meet if they chose to compete.

THE CHAIRMAN: Were the rates fixed by the Government Railways in those days?

MR. O'DONNELL: Well, I assume what the Drayton-Acworth Commission said was that there should not be that freedom which existed on the part of the Government in putting in the rates as it might choose and if the Canadian Pacific wanted to meet them, as I say, the Canadian Pacific would be absolutely forced to follow any rate reduction by the Government Railways on pain of losing the business entirely.

THE CHAIRMAN: Does it mean that so far as the Government Railways are concerned, the freight rates and so on were fixed by the Minister of Railways?

MR. O'DONNELL: I think that was the situation which prevailed prior to that time and in order to protect the Canadian Pacific Railway against that kind of thing happening in the future, the Drayton-Acworth Commissioners suggested that all Government Railways should be placed under the jurisdiction of the Board of Transport Commis-

sioners. That was done.

THE CHAIRMAN: How does the question arise today? There is nobody suggesting that that be undone?

MR. O'DONNELL: No, my lord, but I am suggesting that when this extract from the Drayton-Acworth Report, isolated as it is, is put into Mr. Norman's statement, it is to conjure up the fear that that type of situation might arise again if the Government grants the Canadian National the relief it asks for in its present proposal. I simply say that cannot happen. The Drayton-Acworth proposals were acted upon. All railways today are under the Board of Transport Commissioners—all Dominion railways, and that that cannot arise.

THE CHAIRMAN: Does this control by the Board prevent railways from competing in rates?

MR. O'DONNELL: They file joint tariffs. They have their rates fixed by the Board and throughout the years since the Drayton-Acworth recommendations were put in, that situation has never arisen and with the Board of Transport Commission^{ers} in control I submit it won't arise and it cannot arise.

THE CHAIRMAN: You may submit it won't arise but how can you submit it cannot arise?

MR. O'DONNELL: Well, with the filing of joint tariffs -

THE CHAIRMAN: What is to prevent one or the other from lowering its rates?

MR. O'DONNELL: Well, they have never done it.

THE CHAIRMAN: Do not you do it right along with your competitive rates?

MR. O'DONNELL: To meet truck, to meet water and that kind of thing but not to indulge in rate wars with the other railway. That is not done.

THE CHAIRMAN: It would be against the spirit, I suppose - the co-operation but as a matter of possibility it is possible?

MR. O'DONNELL: Under the statute, as I understand it today, that would not happen.

THE CHAIRMAN: You say it would not happen - That is one thing. The point is: could it happen? Would there be anything illegal in it? If so, would you go so far as to say that it ought to be made illegal?

MR. O'DONNELL: Well, certainly I would agree to that - yes.

-

-

THE CHAIRMAN: All right, Mr. O'Donnell.

MR. O'DONNELL: Thank you, my lord. I had just referred, my lord, to the recommendations in the Drayton-Acworth Report regarding the placing of the railroads under the jurisdiction of the Board of Transport Commissioners, and in that connection I found in a book entitled "Railway Nationalization in Canada" by Dr. Leslie T. Fournier of Princetown University, the following passage. The book was printed in 1935, and I would scarcely think that the author had been subsidized possibly by the Canadian National to write this particular treatise. However, he does say this at page 345:-

"When the majority of the Drayton-Acworth Commission recommended Government ownership in 1916 as a solution of Canada's railway problem, they stressed the importance (1) of safeguarding the administration of the Government railway system from political influence, and (2) of protecting the Canadian Pacific from unfair competition with respect to railway rates. By placing the Canadian National under the jurisdiction of the Board of Railway Commissioners the problem of rate competition was satisfactorily met, but the problem of administration of a Government railway system in a democratic country was more difficult to solve."

And then on the same page is the further statement:-

".....the Canadian Pacific was safeguarded against unfair rate competition."

I say that rates are under the jurisdiction of the Board, and that there is not much danger of any occurrence such as that which might have prevailed during the years before the Drayton-Acworth Commission, when the Government Railways were operated as a Department of Government and subject to all the pressures that were then available by way of dealing with the matter politically.

THE CHAIRMAN: Can you point to anything in the Railway Act which puts an end to competition of that sort?

MR. O'DONNELL: I say it places all railways over which the Dominion has legislation, under the jurisdiction of the Board of Transport Commissioners, and the rates are fixed by the Board of Transport Commissioners.

THE CHAIRMAN: Yes, I know the rates are fixed by the Board of Transport Commissioners.

MR. O'DONNELL: And that as a practical matter - -

THE CHAIRMAN: But leaves the rates fixed by the Board of Transport Commissioners quite a lot of freedom?

MR. O'DONNELL: There is a certain amount.

THE CHAIRMAN: And they are not compelled to act together?

MR. O'DONNELL: No, but I think for all practical purposes during the years that has happened.

THE CHAIRMAN: They have done it?

MR. O'DONNELL: Yes, I don't think that either one of the railways, with the difficulties under which they have all been operating, is going to step out at anything like the rate that might have been possible under the old set up.

THE CHAIRMAN: No, but if there is any fear in existence at all (I am not saying that any fear is justified) but if there is, ^{it} would be that you might get into the position where you could afford to compete by these methods?

MR. O'DONNELL: Well, I don't think either of them could, either railway can afford to compete for it.

THE CHAIRMAN: No, that I say the fear is you might become able to. In that case it will be asserted to us that there is no law to prevent you, notwithstanding what the author says there.

MR. O'DONNELL: Right, I think that that is something that might have prevailed during the days before.

THE CHAIRMAN: And it may be worthwhile to inquire whether it would be advisable to amend the Act in any way to prevent it. You say you would not object to any amendment because you say it would not occur.

MR. O'DONNELL: No, I am quite satisfied it won't occur.

THE CHAIRMAN: And it may not be advisable, I don't know.

COMMISSIONER ANGUS: You told us a few minutes ago that one railway alone could go to the Board.

MR. O'DONNELL: Yes, sure.

COMMISSIONER ANGUS: Suppose one did and the other did not. Now one gets a higher rate, dominant so to speak.

MR. O'DONNELL: There is one rate fixed, the ceiling is fixed.

THE CHAIRMAN: The ceiling is fixed?

MR. O'DONNELL: It can be fixed on the application

that the other is not going to exact a toll that is so fixed as a ceiling. They have been operating on the basis of their getting all the revenues they can everywhere it is possible.

THE CHAIRMAN: Yes, but everything you say just leaves on one side the question of unfair competition.

MR. O'DONNELL: Yes.

THE CHAIRMAN: Now then, that is the point. Is the Board empowered now, to disallow the rates fixed by any railway in any part of the country on the ground that those rates constitute unfair competition to another railway?

MR. O'DONNELL: Well, offhand I don't know.

THE CHAIRMAN: Well, that is the point.

MR. O'DONNELL: Yes, I will look into that. If there were discrimination or unfairness, certainly the Board in those cases would be -- the railways endeavoured to increase competitive rates at one stage in the last few years and those increases were disallowed.

THE CHAIRMAN: But increases?

MR. O'DONNELL: Yes.

THE CHAIRMAN: But nobody is fearing that. In the present question there is no fear of increases being expressed: it is decreases.

MR. O'DONNELL: Yes, but I am simply putting it as a matter of practical railway operation, that through the years since the Board of Transport Commissioners has jurisdiction over the Government railways, it has not arisen and I suggest that there is not any serious possibility of its arising.

THE CHAIRMAN: Well then, there remains the

the question: would it be possible to legislate so as to make it impossible?

MR. O'DONNELL: Yes, well - -

THE CHAIRMAN: If the Act is not already there to prevent it.

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: All right, go on.

MR. O'DONNELL: Yes, my lord. My respectful submission is that the railways are adequately protected and that any fear that the Board of Transport Commissioners would not do its duty -- and it is that I am endeavouring to meet because it was suggested that one would not join with the other in applying for an increase, and I was simply saying that both were free - -

THE CHAIRMAN: Yes, I don't think we need take any more time on that.

MR. O'DONNELL: That is the only one I had in mind. Now, just by way of general comment on Mr. Norman's evidence, I might say this, that his suggestion that the C.N.R.'s proposal is to give over a billion dollars of interest-free capital -- a subsidy of approximately \$300 million per annum -- complete ignores the reasons for and the object and result of the proposal.

The fact is it is based on the premise that as at the time of amalgamation there was a wholly unjustified overload of interest-bearing debt imposed upon the Canadian National, and that further interest burdens have been added thereto in the interval, and that aspect is completely ignored by Mr. Norman in his approach to it.

And the use of phrases such as "hidden subsidy" and "some \$3000 million to more or less

spend as they see fit" and again" a free pocket of money to do as they see fit with" -- that those are unfounded and unreal and that they are not risks at all that would justify denying an adjustment of the claim of the Canadian National which in effect the witnesses to whom I refer, Mr. Northey Jones and Mr. Norman, didn't even examine as to the merits of the claim and go into the contents of it in any way at all satisfactory to warrant their expressing a view that should be given weight.

Now, I say, equally applicable today are the remarks of the then Minister of Transport, the Honourable Mr. Howe, which were made on 18th February 1937 concerning the attitude taken by the C.P.R. regarding the proposals now advanced by the Canadian National for the adjustment of its capital structure. Mr. Howe at that time, 18th February 1937, said:-

"At various times the proposal for C.N.R. capital adjustment has been attacked, particularly on the ground of its being some sort of an attempted deception of the people of Canada and as doing violence to the principles of sound finance. Such criticism is without foundation and obscures from the people of Canada the true purpose of the plan with its ultimate advantages to the Dominion and the railway. It ignores the expressed views of competent and impartial tribunals as well as the terms of the financing legislation since 1932. It runs counter to the usual financial and accounting practices of corporations

under similar conditions. Further, this criticism refuses to recognize the effect of the events of the last twenty years on present-day realities, in that the position of the Dominion has come to be essentially that of shareholder and proprietor in the Canadian National Railways, -- not of creditor in the ordinary sense."

Now, I say that those words apply equally today with the situation which prevails. The position of the Government is even more that of shareholder today than it was at that time. It is not a creditor in the ordinary sense at all as it was at that time.

Now, the excessive interest-bearing debt burdens from which Canadian National requests relief, have been evaluated in equivalent terms of either positive or negative capital by people whom, I suggest, are acknowledged experts, and the suggestion that the adjustment is in any sense a subsidy, let alone a "hidden subsidy" is unfounded. I submit that the proposal constitutes nothing but a justifiable adjustment of an improper situation and the removal of burdens which should never have been imposed.

To put it as did Dean Cronkite for Saskatchewan in argument, he said at page 21712:-

"It is unfair that the system should be saddled with an obligation of a debt for which it has not received value -- quite the reverse of receiving a subsidy."

We say to Mr. Norman, in discussing his testimony, that we have in mind the desirability of impressing on the Commission the fact that he is not

altogether out of agreement with the suggestion that the Canadian National is entitled to a revision of its capital structure.

Mr. Norman has indicated at many points throughout his testimony that something should be done and he has supported many of the arguments that have been advanced on behalf of the Canadian National, justifying its claim that it bears excessive capital burden.

(Page 24078 follows)

At other places he has stated, in effect, that he was not sufficiently familiar with the details of our operations to express firm opinions, and he indicated that our personnel had made, the Canadian National personnel had made, studies of a nature which he had not undertaken.

I say that he acknowledges strength in the Canadian National proposals. He said in part, at page 20642:

" . . . Even so, there may be some merit in the C.N.R. request that the total fixed charges be reduced in order to provide greater flexibility and to avoid deficits in periods of reduced traffic."

And again at page 20630 Mr. Norman said:

"In regard to the expenditures for properties which are not justified from a business or commercial viewpoint I have previously stated that any parts of the railway operations which are undertaken solely as a matter of government policy should be kept separate from the commercial transportation enterprise in order that appropriate government subsidies may be voted to cover the deficits. It would seem to me that it would be preferable for all operations of this type to be managed for the account of the government rather than to be merged with the Canadian National System until such time as they show an earning capacity from a commercial point of view or become an integral part of the C.N.R. System when they should be merged into the accounts of the C.N.R."

THE CHAIRMAN: Who said this?

MR O'DONNELL: Mr. Norman, my lord. I am saying he agreed that something should be done, and he made some proposals along the line of supporting the end result that we have in mind. His approach was different, but he did

support the general proposition that we were entitled to an adjustment. That is my interpretation of his evidence.

Again, at page 20622, I say he supports our request that we are entitled to an adjustment by making reference to the Newfoundland situation. He said there:

" . . . There is no question in my mind but that operations such as the Newfoundland Railway and Steamship Services should be segregated and operated purely as an agency for the Government and the Government should meet deficits, if any, through annual appropriation."

It is items such as those mentioned by Mr. Norman that the Gordon plan attempts to adjust on a reasonably justifiable and conservative compromise basis.

Regarding Mr. Norman's suggestion (at p. 20634) that there should be eliminated "from property investment of C.N.R. those properties which are operated from a strictly national governmental policy and on which no return should be expected, this property to be operated on an agency basis for and on behalf of the government" -- and at page 20672:

"Q. But what you would apparently do is to eliminate from that investment such of these as operate for the national purposes in the way in which you have just defined them?

A. That is correct; such as those which are indicated maybe by Mr. Gordon. I do not know whether they are all of that same character or not."

The Gordon Plan attempts to make exactly that kind of adjustment.

Mr. Norman's answer is an admission that an adjustment for such lines is justifiable and desirable.

Mr. Norman acknowledged also very frankly that

his suggestions were but one method of carrying out such an adjustment and that there were others which would be equally satisfactory.

At page 20734 Mr. Frawley put a question to him:

"Q. Now, the third comment that you have to make on the Gordon plan is that the uneconomical lines must be segregated, and they must be put into the hands of the Canadian National on an agency basis?

A. That is correct.

Q. Just as the Hudson Bay Railway has done?

A. Yes."

Here again Mr. Norman, I submit, acknowledges that the Canadian National is entitled to consideration and some adjustment concerning these lines; and I say again, it is exactly this Mr. Gordon's plan is designed in part to do, although his approach is quite different from that of Mr. Norman.

THE CHAIRMAN: We will adjourn until tomorrow morning.

---The Commission adjourned at 4:30 p.m., to meet again at 10:30 a.m. on Friday, May 26, 1950.

A.R.

3-11-51

ROYAL COMMISSION
ON
TRANSPORTATION

EVIDENCE HEARD ON

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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, May 26, 1950

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
FRIDAY
MAY 26, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN
HAROLD ADAMS INNIS - COMMISSIONER
HENRY FORBES ANGUS - COMMISSIONER

- - - - -
G.R. Hunter
Secretary
- - - - -

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| F.M. Covert, K.C. | } | Royal Commission on Transportation |
| G.C. Desmarais, K.C. | | |
| H.E. O'Donnell, K.C. | } | Canadian National Railways |
| N.J. MacMillan | | |
| H.C. Friel, K.C. | | |
| C.F.H. Carson, K.C. | } | Canadian Pacific Railway |
| F.C.S. Evans, K.C. | | |
| K.D.M. Spence | | |
| I.D. Sinclair | | |
| M.A. MacPherson, K.C. |) | Province of Saskatchewan |
| J.J. Frawley, K.C. |) | Province of Alberta |
| C.D. Shepard |) | Province of Manitoba |

- - - - -

Ottawa, Ontario,

Friday, May 26, 1950

MORNING SESSION

ARGUMENT BY MR. O'DONNELL (Cont'd)

THE CHAIRMAN: Very well, Mr. O'Donnell.

MR. O'DONNELL: My lord and members of the Commission, I have no doubt that the Commission saw the report in yesterday's papers to the effect that the Board of Transport Commissioners had handed down its decision in the matter of the application of the railway companies for authority to increase their tolls in respect of freight rates. The decision of the Board will permit the railways to increase freight rates generally by 4%, that is, the 16% has now been increased to a full 20% as originally applied for by the railways.

I thought perhaps you might be interested to know the effect on the income account of the Canadian National which that would have. I have mentioned in my argument several times that, according to the evidence given by the railway officers, they were of the opinion that if the proposals for capital revision were approved and implemented the Canadian National could only expect to about break even taking the good years with the bad. I have had a statement prepared showing the net income results which might be expected by the Canadian National for the year 1950. I would ask that it be produced as Exhibit 289. Perhaps it might be better for convenience to just put it right into the record rather than making it an exhibit.

CANADIAN NATIONAL RAILWAYS

Estimated Net Income Results - Year 1950

| | | |
|--|----|-------------------------|
| Budget - as examined and adopted by the Sessional Committee of the Commons, 11th May, 1950 | | \$ 32 236 000 (Deficit) |
| Additional revenue <u>if the 16% increase</u> <u>in freight rates had been in effect</u> <u>for full year instead of from</u> March 23, 1950 - deduct | | 3 286 000 |
| Additional revenues <u>if additional 4%</u> <u>(full 20%) increase in freight</u> <u>rates authorized May 25, 1950 had</u> <u>been in effect for the full year</u> 1950 - deduct | | <u>7 169 000</u> |
| | | \$ 21 781 000 " |
| Elimination of special credit from Deferred Maintenance Reserve (non-recurring) | | <u>9,000 000</u> |
| | | \$ 30 781 000 " |
| Recapitalization proposal granted - deduct | | <u>30 659 000</u> |
| Income as adjusted (available for dividends) | \$ | 122 000 (Surplus) |

This estimate makes no provision for any wage increases
which may result from the current wage negotiations.

MR. EVANS: I do not want to raise an objection at this stage to my friend putting this in but this estimate of the 1950 results has not been approved, and it does seem to be very material to the question which I will have to argue --

THE CHAIRMAN: You say it is not what?

MR. EVANS: The estimate of the results for 1950 has not been proved in evidence, and it might have required cross-examination to establish the basis on which the estimate was made. I do not want to object to my friend putting in proper material but it does seem to me it has a very direct bearing on the argument which I may have to make in reply to my friend.

MR. O'DONNELL: I have no objection at all to my friend cross-examining on it. As far as I am concerned, it only became available as a result of yesterday's decision.

THE CHAIRMAN: Who made it?

MR. O'DONNELL: Mr. Cooper made it, and it merely reflects the change which results from yesterday's judgment. It is connected with the earlier exhibits which were filed by Mr. Cooper in that connection.

COMMISSIONER INNIS: Following up Mr. Evans' comment, just how accurate are these various estimates that are put forward as to what the rate increases will yield?

MR. O'DONNELL: They are amazingly accurate. I think I can say that, and I think Mr. Evans will agree with me that when we go before the Board of Transport Commissioners these estimates are amazingly accurate year in and year out, and it is on estimates of that kind that increases have been dealt with. In cases before the judgment or order might have come down, and

the final results had come in, then the Board would review the matter on the latest available data, but through the years I think Mr. Evans will agree with me that estimates of the traffic as provided by the railway officers are really amazingly accurate.

COMMISSIONER INNIS: For how long a period, a year ahead?

MR. O'DONNELL: Usually a year ahead. That is about as far as they ever go. But testing them by looking back over the years, in so far as I am concerned since 1946 we have quite a number of estimates before the Board of Transport Commissioners, they act on them and accept them, and they have proved to be very close to actuality when the actual figures have been available.

MR. EVANS: I am really concerned not only with revenues but with expenses, and I should like to know the basis on which the expense estimate was arrived at. It does seem to me we can get the full effect of the recent judgment reflected by applying it as we did in one of the exhibits to the year 1949, because it is in regard to that year that the Board's judgment purports to restore or redress the imbalance. It was not with regard to the year 1950 because the Board had no evidence before it of any kind as to the possibilities in 1950 for either railway.

MR. O'DONNELL: The Commission will remember we put before the Commission an estimate of the deficit which we would have. We referred to the budget which had been presented to the House of Commons Committee, and I intend to make reference to that. I have no objection to Mr. Evans asking Mr. Cooper anything he may please about it.

THE CHAIRMAN: What is this \$9 million item?

MR. O'DONNELL: That is the deferred maintenance

reserve which will not be a recurring item. That is a special item which will not be available any further, and Mr. Cooper makes up his estimate on that basis.

THE CHAIRMAN: Why will it not be available any further?

MR. O'DONNELL: Because the fund has been exhausted. It was a fund that was created during the war and was to be spread over five years, and that is the end of it.

THE CHAIRMAN: This is the end of it.

COMMISSIONER ANGUS: Would it not be used for meeting expenses that would not recur?

MR. EVANS: That is exactly my point about the \$8 million item in the exhibit filed for 1949. This goes to increase the deficit for the year 1950.

MR. O'DONNELL: The Commission will note the first figure at the top of the statement is the budget figure as examined and adopted by the sessional committee of the House of Commons on the 11th of May, 1950. I have the report here and I have the budget, and I intend to put all the data before the Commission. If Mr. Evans would like to ask some questions about it that is quite all right with me.

COMMISSIONER ANGUS: The question I asked was this. If you are taking the estimate for the next year you say this item of \$9 million of income would not be recurring but would it not also be the case that your expenditures on maintenance would be \$9 million less than in the year we are examining here?

MR. O'DONNELL: This \$9 million is a special amount that we have available in this particular year which we won't have available next year.

COMMISSIONER ANGUS: Is it not spent because in this particular year there is work left undone that

has to be done, abnormal work, extra work, and that there will not be a corresponding expenditure in the next year?

(Page 24086 follows)

MR O'DONNELL: Well, as I understand it and remember it, it is hard to say that. All I am saying is that \$9 million will not be available in the next year, whereas it is this year, and expenses will be just that much more.

COMMISSIONER ANGUS: And you think that your expenditures on maintenance next year will be substantially comparable to those in 1950?

MR O'DONNELL: I think so. We have ordinary maintenance expenditures every year, and we will not have that amount of money which was earmarked as a deferred maintenance reserve. The reserve is exhausted, and will no longer be available in the circumstances, and we will be just that much worse off.

COMMISSIONER ANGUS: You do see what I am driving at in my question, don't you?

MR O'DONNELL: I think I understand, yes.

COMMISSIONER ANGUS: I assumed that a deferred maintenance reserve was something that was kept in cash because you had not been able to do the work.

MR O'DONNELL: Yes.

COMMISSIONER ANGUS: And that therefore that work had been left over to be done as an extra in future years.

MR O'DONNELL: Yes.

COMMISSIONER ANGUS: And that this money was appropriated in this year because there was extra work to be done in this year.

MR O'DONNELL: Yes.

COMMISSIONER ANGUS: Now, in a subsequent year would there still be extra work to be done?

MR O'DONNELL: There will be extra work in all years for a long time to come, as far as I am concerned,

over and above what would be ordinary maintenance.

COMMISSIONER ANGUS: Your maintenance reserve is inadequate?

MR O'DONNELL: Oh, yes, When we were before the Board of Transport Commissioners in the 21% Case, Mr. Wheelwright, the Chief Engineer, said, as I remember it, that generally there are millions and millions of dollars of work to be done, and what can be done in an ordinary year is what appears in the expenses. Now, in so far as this particular year is concerned, if we had not had that reserve available our deficit position would have been just that much worse. This is a non-recurring item, and we have to eliminate it; it will not be available at any other time, and it makes the position just as is shown on Exhibit 289. Now, I have no objection to Mr. Evans asking Mr. Cooper; he is not here right now, but if the Commission would like to get further information about it, that is quite all right with me. All I am saying is that the figure at the top of Exhibit 289 is the budget figure approved, examined and adopted by the Sessional Committee on the 11th of May, 1950, and the next document I wished to file was that budget itself, showing the deficit of \$32,236,000 -- that is the operating budget -- and also the report of the Committee approving that. Now, the only change that has taken place in the interval is that which occurs by reason of the increase in revenue which will result from yesterday's judgment of the Board of Transport Commissioners, and I thought we should have the complete picture, and in those circumstances I asked Mr. Cooper to prepare this Exhibit 289. Subject to that, if Mr. Evans would like to ask Mr. Cooper anything, that is quite all right.

THE CHAIRMAN: I suppose the two figures which

might be questionable there as to their accuracy are the two additional revenue figures.

MR EVANS: I really have two objections, my lord. One objection is that the restoration of the imbalance was done on the basis of 1949. Now then, in my opinion, to assume that 1950 conditions reflect the restoration of the imbalance that was in the Board's mind is to assume that there are no conditions in 1950 which may give rise to the need for a further increase in rates. That is the first thing. The second thing is that there is no need for this exhibit, because you can, taking the 1949 results on the exhibits that we now have, find out what the judgment has done to restore---

THE CHAIRMAN: Is that what Mr. Cooper did, though?

MR EVANS: He has done it.

MR O'DONNELL: Yes, and he explained the deferred maintenance matter when he was here before. It is nothing new; he has not changed that at all. He gave a full explanation, if I can find the reference in the record to it. He was questioned at length about that.

THE CHAIRMAN: You see, Mr. Evans, if we consider these figures at all we shall have to consider them with all the infirmities that you point out. They are figures showing us in these two items what additional or other revenues it is thought would have been earned if certain things had occurred, and we are told that Mr. Cooper in making them up took the figures for the 1949 returns which are already in evidence. That is so, isn't it?

MR O'DONNELL: That is right.

MR EVANS: I think there is some misunderstanding there. If I understand your lordship correctly, Mr. Cooper does not reflect anything out of 1949 in this. We have exhibits before us---

THE CHAIRMAN: He told us he did, that he took exhibits already in for 1949 and used them as his basis. Is that what you told us, Mr. O'Donnell?

MR O'DONNELL: Well, this budget, my lord, has the 1949 figures on it and has the 1950 figures on it, and it---

THE CHAIRMAN: I am not talking of your budget. That is what the Senate found.

MR O'DONNELL: Yes.

THE CHAIRMAN: I am talking of these two, the two immediately following items, additional revenue in one case at \$3,286,000, and additional revenue in the other case at \$7,169,000. Now, those are estimates, of course.

MR O'DONNELL: Yes.

THE CHAIRMAN: Now, what are they based on?

MR O'DONNELL: The estimate of \$3,286,000 is the additional revenue if the 16 per cent increase in freight rates had been in effect for the full year instead of from March 23, 1950.

THE CHAIRMAN: I know, but the full year 1950.

MR O'DONNELL: Yes.

THE CHAIRMAN: Well, that must mean, then, that you had some means of estimating the revenues for 1950.

MR O'DONNELL: Yes, and that is contained in the budget which I intended to file. That is the one that was examined and criticized by the Senate, and upon which the report was made adopting it and---

THE CHAIRMAN: Yes, but now this budget of \$32,236,000, is that what you are filing?

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: Now, is that an estimated deficit for 1950?

MR O'DONNELL: That is the deficit estimated and

reviewed by the---

THE CHAIRMAN: For 1950?

MR O'DONNELL: Yes, for 1950; and it is reported on by the Committee, and I have the fifth report of the House Sessional Committee on Railways and Shipping, and I intended to file the whole tabulation and the report and have the information fully before the Commission. Then the only change since that is as a result of yesterday's increase, and that item then of \$7,169,000 is the additional revenue which it is estimated would be received by reason of yesterday's increase if the additional 4 per cent increase in freight rates authorized on May 25, 1950, had been in effect for the full year. We will not have it in effect for the full year, but if it had been in effect for the full year we would have \$7,169,000 more. I think that is relevant, and I wanted to file these two other documents which show the first figure, \$32,236,000, and gives entire detail---

THE CHAIRMAN: What is the ultimate purpose of all this?

MR O'DONNELL: The ultimate purpose is to establish that these great surpluses which are suggested or intimated may occur if the adjustments are put into effect as proposed by the Canadian National, are not in fact correct, and that on the basis of Exhibit 289, even if we get all the proposed adjustments we have asked for, and if we take into account the additional revenues that could accrue over a full year as a result of yesterday's increase of 4 per cent, we would only end up with a surplus of \$122,000 in the year 1950, on the latest available figures. That brings the situation right up to date.

And I think the Commission would be interested in studying the latest available data and I have no objection if Mr. Evans would like to ask Mr. Cooper some questions. I say the deferred maintenance item was gone into fully when Mr. Cooper was here before. There has been no change in that situation and it is on the record. I do not know if we have yet found the place, but it is on the record. If Mr. Evans would like to cross examine Mr. Cooper it is in the hands of the Commission as far as that goes.

THE CHAIRMAN: Well, do you feel that Mr. Cooper could give you any more enlightenment than you have now?

MR. EVANS: I do not know. I have not seen the budget figures myself and I would certainly like to have a chance to look them over before I undertook to cross examine him.

THE CHAIRMAN: All right, we will reserve that.

MR. O'DONNELL: I will put all that in the record and Mr. Evans can look it over on the weekend.

MR. EVANS: Well, I will have to be on my feet on Monday morning, so that does not allow me much time.

MR. O'DONNELL: Well, I had to reply to you too.

MR. EVANS: Yes, but my evidence was all in.

MR. O'DONNELL: Some was, and some was not.

MR. EVANS: It was all in.

THE CHAIRMAN: I think we all understand what might be called the possible fragility. We will bear that in mind.

MR. O'DONNELL: I would then file, my lord, as Exhibit 289, the budget of the Canadian National Railways. There is attached to it another budget of one of the subsidiary steamship companies for the year 1950.

THE CHAIRMAN: You said a budget?

MR. O'DONNELL: Yes, my lord, as submitted to the Sessional Committee on Railways and Shipping, owned, operated and controlled by the government, and adopted on May 11th, 1950, as appears by the Report of the Committee dated that day, which is contained in the Minutes of Proceedings Number 9, and I would ask to file the budget as Exhibit 289.

THE CHAIRMAN: You are not making an exhibit of the other one?

MR. O'DONNELL: Well, Mr. Covert suggested we put it right in the record which is a very convenient thing to do, and this, as Exhibit 290 -- the Minutes of Proceedings Number 9.

EXHIBIT No. 289: Budget of the Canadian National Railways and the Canadian National West Indies Steamships Limited for calendar year 1950.

THE CHAIRMAN: Have you still another?

Mr. O'DONNELL: Yes, I have the Sessional Paper here and I would just draw attention to page 595 of Exhibit 290.

THE CHAIRMAN: What is Exhibit 290?

Mr. O'DONNELL: That is the minutes of proceedings of the committee.

EXHIBIT No. 290: Minutes of Proceedings of The Sessional Committee on Railways and Shipping owned, Operated and controlled by the Government dated 11 May, 1950.

THE CHAIRMAN: Of the Senate committee?

Mr. O'DONNELL: No, this one is the House of Commons committee, my lord, and on page 596 of Exhibit 290 the following appears:

"The financial budget of the Canadian National Railways and the Canadian National West Indies Steamships Limited for the calendar year 1950

was examined and adopted."

And as a result of the adoption the adjustments were made and they are in the revised budget which appears in Exhibit 289. The budget adjustments have been increased to show the additional revenues which would have been received if the recently authorized freight rates increase had been in effect for the full year 1950. I point out that they won't be in effect for the full year. The relief of \$30,659,000 on the interest charges had been applied on the assumption that Mr. Gordon's proposal had been approved and in effect for the whole year 1950 -

THE CHAIRMAN: What did you say about Mr. Gordon's proposal?

Mr. O'DONNELL: If Mr. Gordon's proposal granting relief from these interest-bearing charges totaling \$30,659,000 -

THE CHAIRMAN: You are talking of Mr. Gordon's proposal to us?

Mr. O'DONNELL: Yes, sir.

THE CHAIRMAN: What is it you say?

Mr. O'DONNELL: I say that if the proposal which Mr. Gordon advanced to the Commission for relief from interest-bearing charges, the relief being \$30,659,000 - if that had been applied, then the position would be as shown on the statement which is now in the record and would result in a surplus only of \$122,000 provided the relief had been in force for the full year and provided the increase had been in effect for the full year.

COMMISSIONER INNIS: Disregarding Mr. Gordon, what would it have been based on the original submission?

Mr. O'DONNELL: Well, disregarding the Canadian National Railway's plan, it is \$30,659,000.

COMMISSIONER INNIS: That is to say, what you are taking now is the Canadian National Railway plan in the

beginning?

Mr. O'DONNELL: That is right.

COMMISSIONER INNIS: It is really not Mr. Gordon's?

Mr. O'DONNELL: No, it is the Canadian National Railway plan. The Canadian National Railway wants relief to the extent of \$30,659,000 - the loan in the hands of the government and then the interest on the \$300,000,000 indebtedness which total \$30,659,000.

COMMISSIONER INNIS: This includes the \$300,000,000?

Mr. O'DONNELL: Yes.

COMMISSIONER INNIS: What would it be without that?

Mr. O'DONNELL: \$21,659,000. That \$21,659,000 is made up of the two items.

COMMISSIONER INNIS: Based on your old submission it would be \$21,659,000?

Mr. O'DONNELL: We have one submission, in my interpretation.

COMMISSIONER INNIS: Mr. Gordon's is supplementary as I understand it. It came in later?

Mr. O'DONNELL: Well, there is one submission only and that is that we be granted total relief to the extent of interest-bearing debt amounting to \$1,060,000,000. That is the proposal. It is made up of two parts, that is true. We, in the first instance, had computed the situation without the benefit of the studies which were made later. When we had available the studies which were made later concerning the thin traffic lines in the national interest and the other items we reviewed on that tabulation, we completed the proposal and we say that the total burden that we are bearing and should not bear is

\$1,533,000,000 and we propose that relief to the extent of \$1,060,000,000 be granted to us and we propose to get \$1,060,000,000 through the \$1,500,000,000 in the hands of the government at the present time and then the additional \$300,000,000 was to be set up as an indebtedness or a credit. Taking the benefit of the relief which would be accorded by those two items, we would get this figure of \$30,659,000; that is, \$21,659,000 as a result of the interest on the bonds in the hands of the government which we suggest should be exchanged for equity stock and \$9,000,000 more on the \$300,000,000.

Now, the commission, I think, will note how the adjusted budget I have just filed compares with the figures which were laid before the Commission. The net income for the year 1950, as disclosed by the statement which is now incorporated in the record and which is the most up to date presentation that can be made, is that the railway in the year 1950 will make a profit of \$122,000.

THE CHAIRMAN: That is if you get all you are asking?

Mr. O'DONNELL: If we get all we are asking - yes, and if we get the relief we are asking and if we assume we do get it for the full year 1950 and if we get the increased revenue that would accrue from yesterday's increase accorded by the Board of Transport Commissioners - if we had had that for the full year (and we won't have it) then we would only have \$122,000 profit at the end of the year.

(Page 24098 follows)

COMMISSIONER INNIS: Amazing how neatly it has worked out.

MR. O'DONNELL: It is very amazing. It goes to prove the accuracy, in my submission, of the forecasts and estimates of the officers when they were here. It just so happened that we have been here long enough to have available to us later data which helps to verify and support what was previously said. That is purely coincidental.

The statement carries a footnote to the effect that no provision has been included for any wage increase which may result from wage negotiations now taking place.

Yesterday, Dr. Innis (I think it was you) mentioned or referred to the \$100 million item which we had said was an estimate which represented necessary improvements to the property which did not add to the earning power of the system.

COMMISSIONER INNIS: Yes, the day before, I think.

MR. O'DONNELL: The day before yesterday, I have not got the page of the record exactly. In that connection I would just draw your attention to Vol. 103 at page 19114 where the matter was referred to when Mr. Fairweather was here. I don't know whether you would like me to go over it.

COMMISSIONER INNIS: No, I remember it.

MR. O'DONNELL: But I think Mr. Fairweather gave some testimony as to the extent of the work which had been done, and I understand that it involved hundreds of miles of trestles and things of that kind. But between pages 19114 and 19117 I think you will find, Dr. Innis, the information that you have referred to.

I would like to advert to where we were yesterday, and I think I was just reviewing Mr. Norman's evidence, and I had said that I thought Mr. Norman supported our proposals in quite a number of aspects, and that he had acknowledged by his evidence that the Canadian National is entitled to consideration and adjustment, and particularly concerning such lines of railway as those which were operated in the national interest, the Newfoundland Railway, for instance, and the Temiscouata and those.

Now, I will pick up from where I left off yesterday in Vol. 134 at page 24080.

Mr. Norman agrees that "the C.N.R. fixed charges are excessive, yes" (Page 20743). The Transcript reads: "The charges are excessive, yes" and "The charges" which are referred to are the C.N.R.'s fixed charges.

I think it can fairly be said that the C.P.R. through its counsel and through Mr. Norman, its witness, have stated that they agree that the capital structure of the Canadian National should be revised. They suggest, however, means other than those which have been formally proposed by the Canadian National. Now, while perforce conceding that an adjustment is justified, they introduce the question of income bonds, and indicate that their use might be one of the procedures resorted to.

THE CHAIRMAN: Who introduced that?

MR. O'DONNELL: The C.P.R., my friend Mr. Evans, mentioned that during the course of the discussion, and they suggested that that might be one of the methods; whereas the formal submission of the Canadian National is that the adjustment should be worked out through the use of but two classes of capital, that is, the borrowed capital to a certain extent

to continue to bear interest, and equity capital represented by common shares.

All I point to there is that while they suggest in our case the use of income bonds, the C.P.R.'s common equity capital is represented by shares, not by income bonds. In contradistinction I say that the management and the Board of Directors of the Canadian National gave it as their considered and definite view that in so far as equity capital is concerned it should be represented by common shares. Psychologically the income bond, as everyone knows, (I have seen it referred to) is the hall mark of bankruptcy, I think it has been designated as.

Mr. Cooper at page 18689 quoted the Deputy Minister of Finance, Dr. Clark, as having told him that "he thought that income bonds were the lowest types of security." In the circumstances, is it unfair, I ask, or unrealistic, that Canadian National should prefer freedom from the cloud or the stigma which attaches to income bonds; and that it desires for itself, to use the words of my friends, "a strong, healthy, dynamic and vigorous existence" such as the C.P.R. states it desires for itself. Those words are used at pages 20420-21 and 20513. What the C.N.R. desires is the right to service its equity capital as does the C.P.R.

MR. EVANS: And to declare dividends?

MR. O'DONNELL: Service the capital, I say. If there are earnings, declare dividends or handle it some other way, but service the equity capital, as and when there are earnings available. Now, the C.P.R. does it, as my friend remarks, through declaring dividends.

THE CHAIRMAN: Now, what obligation would income

bonds impose on you more than shares would, more than equity capital?

MR. O'DONNELL: It might not impose any other obligation on us except that we prefer to have our capital structure set up on relatively the same - -

THE CHAIRMAN: Well, they would be held by the Government?

MR. O'DONNELL: Yes, I am coming to that, they would be held by the Government, and I have some remarks on that.

The position in our case does not necessitate or need or require any income bonds, and I will elaborate on that in just a few moments. I say that all the C.N.R. desires is the right to service its equity capital as does the C.P.R. Income bonds are not justifiable in the circumstances, in the view of the Canadian National, in that they carry an implication that the debt being dealt with was properly imposed in the origin, whereas our case is that these burdens were incorrectly saddled upon the C.N.R. at the offset of its existence or since that time. Furthermore, we say that income bonds serve no purpose in our particular case, as the holder of these bonds, as your lordship remarked, would also be the owner of all the equity capital and be entitled to all returns which are available for payment on income bonds or as a return on equity capital by way of dividends. Those are the special facts of our case: the owner is entitled to all the equity and to all the returns.

Now, the equity of the Government, as the owner of the enterprise, is enhanced to the extent that there are any earnings from time to time, Even if a dividend is not declared and paid, the Government's

position in this respect is no different to that of the shareholders of the C.P.R. or any other corporation.

But, income bonds, we say, are a form of security sometimes attractive to a person who might wish to become a lender of funds but who would not become an investor of funds. Therefore in the case, however, that we are dealing with, it is our respectful submission that this type of security has no place. There is no borrower here, nor is there any lender. The Canadian National is dealing with its own owner, one owner, the Government. Income bonds presuppose a borrower and a lender, different parties having different rights.

THE CHAIRMAN: You yourself introduced this relation of debtor and creditor when you asked for this \$300 million as acknowledgment of a debt. Why do you put it that way?

MR. O'DONNELL: Well, I put it that way for the purpose of demonstrating that the matter was one strictly between the Government as the owner of the corporation; and it was to simplify, or endeavour to demonstrate how relatively simply the adjustment could be made, that we put it in that particular form. But I am saying that in this case here the income bonds, we are not getting any loan from the Government at this time. We are suggesting that this old accumulation of excess charges which should never have been imposed on us, should be settled in a certain way, and we are suggesting it can be done very simply through the exchange of one type of security for these bonds that it has in its possession.

THE CHAIRMAN: What exchange, what are the two things being exchanged?

MR. O'DONNELL: Well, we ask for \$1,060 million relief against the claim of \$1,533 million; we say that the \$1,060/^{million} can be settled in that way, that the Government will exchange the bonds which it has in its hands today, the \$760 million of interest-bearing bonds for common stock for a commensurate amount; secondly, that for further common stock it will undertake to set up the \$300 million.

THE CHAIRMAN: For further - -

MR. O'DONNELL: For further common stock, yes.

THE CHAIRMAN: I understand that, but you begin by saying that they acknowledge they owe you \$300 million.

MR. O'DONNELL: Yes, they will agree - -

THE CHAIRMAN: Although they owe you \$300 million you are going to give them stock for it?

MR. O'DONNELL: Yes, because we are compromising or settling the discussion which we have had over the years on that basis. We are not asking for the full \$1,533 million which we say we might justifiably do if we went the entire length. We say, accept the lesser amount because there is a possibility and there are potentialities in the railroad which, the imbalance between rates and costs being restored, will permit us in some years to have earnings that would provide surpluses, and in other years would have deficits; but we say, looking the whole picture over, we think a settlement on that basis is a reasonable adjustment of the entire amount.

THE CHAIRMAN: Well, I can understand, you see, the Government giving you \$300 million and you giving them a consideration of so much equity stock,

but if you want to have it assumed to begin with that the Government owes you \$300 million, why are they entitled to equity stock when they pay you what is owing?

MR. O'DONNELL: No, my lord, I say they should properly give us \$1,533 million; but we say, taking into consideration a number of factors and owing to the difficulty of hitting the exact figure and fixing upon the arithmetically correct amount that we should receive, and owing to, well, the different points of view that one might have concerning one item and another and so on: that it is fair to saw the thing off and settle it on that basis of \$1,060 million. As I said yesterday, if the Government had \$1,060 million of this interest-bearing securities in its hands, then we would suggest that the exchange be effected in that way, that they would receive \$1,060 million of common stock for the \$1,060 million of interest-bearing securities. They have only got \$760 million of these interest-bearing securities, and the rest are in the hands of the public. We therefore suggest that they find the balance of the compromise amount in the way of setting up and acknowledging an indebtedness in the fund of \$300 million that we can draw on to use with the approval of Parliament.

Now, our friends suggest, well, instead of issuing common shares, you should have recourse to income bonds; the Government should receive income bonds rather than common shares. We say there is no place for income bonds here. The use of common shares is a reasonable thing. It is what corporations usually do. If we were out borrowing money, then to entice someone who would not buy our shares but who might be interested in a higher return possibly from income bonds, we might

entice him into buying the income bonds; but that is not the position here. We are dealing with the owner of the enterprise, and the owner of the enterprise is entitled to all the equity in it, and we say the equity in it should be represented in his case by the use of common shares rather than by the use of the income bonds. I say that the only party involved is the owner.

(Page 24106 follows)

Now, the only question is how the owner is to receive the returns, if any, which may be earned. The owner owns them all in any event, in this particular case one owner, no outside parties, no persons in different categories of creditors and so on. For the owner to have to issue income bonds in this instance would virtually constitute a mortgage -- I think your lordship used this example the other day -- by the owner of the property to himself, going through the motions of pretending to give preference to himself, so to speak, against himself. I put that by way of emphasis.

The owner does not need to do all that. The owner would have the stock certificates which indicate that the entire equity capital of the C.N.R. belongs to it, in this case the government.

THE CHAIRMAN: You have the owners in three positions. First they are owners, then they are creditors and then they are debtors.

MR. O'DONNELL: That would be what it would amount to, but what we say is simply this. The government owns the entire venture in so far as the equity capital is concerned. Why confuse the picture? Why not have it a neat and simple transaction with the capital of the venture being divided into that portion which is borrowed, which would remain in the hands of the public, and that portion which is equity which would be entirely in the hands of the government, represented by common shares.

I say that there is a complete merger of interests in the present case vested in the owner of the enterprise, the government of Canada, the sole shareholder by virtue of the Canadian National Railways Act. As I have said, income bonds are sometimes used to distinguish between the rights of different persons in different

categories, creditors, lenders and so on enjoying different preferences and ranking unequally against the possibility of available earnings at some future time.

There is no one to rank against the government as to any earnings which there may be over and above the interest which is owing to the public. There is no one but the government involved in this situation. There are no classifications of categories, no first, second or third groups of shareholders or of income bondholders or anything of that kind. There are just two simple classifications providing for the dividing of the capital of this venture between borrowed capital, bonds, and the equity capital, shares, owned entirely by the one shareholder.

The income bondholder is somewhat in the nature of a mortgagee, as your lordship said the other day, whereas the shareholder, as in the present instance, is the owner. The Canadian National proposes to its owner that its equity in the enterprise be represented by common shares. It is most unusual to propose the issuance of income bonds for the purpose of protecting the interest of a party not either the owner or a creditor of the corporation but an outsider completely. That is the proposal, that it is for the protection of an outsider completely and that the unusual procedure of recourse to income bonds should be had when that outsider is not the owner or creditor nor has it any interest in the corporation as a corporation. This is strictly a matter of internal adjustment in the corporation by the owner of the corporation.

The proposal put forward by the C.N.R. is neat and simple in so far as the capital is concerned. Its capital would be of two classes, (a) borrowed and (b) equity. As to (a) such part of the capital as is borrowed is to continue to be represented by bonds, and as to

(b) the balance of the capital which is equity is to be represented in the ordinary every-day usual corporation manner of equity stock, that is, common shares.

In the years when interest on the bonds is paid and any surplus earnings may still remain, they will be available for disposition by the directors as they may determine. This again is in conformity with the ordinary every-day practice of corporations, including the C.P.R. If the C.P.R., having paid whatever interest it owes, having paid all its operating expenses, taxes, and whatever interest it owes, has any moneys available then the directors of the C.P.R. determine how it shall be used, whether it shall be plowed back in part into plant and equipment, and whether or not a dividend shall be declared.

On the proposal that the C.N.R. makes it would put these two companies on an exactly comparable basis in so far as the handling of the returns is concerned. The directors will determine whether some portion, if there be any surplus, will be plowed back into the company by way of additions and betterments just as the C.P.R. does, and if there is anything available over and above that they will determine how much will be declared by way of a dividend. The C.N.R. suggests that is a fair and proper way to handle the situation, that it is the easy way and has the advantage of simplicity. The plan is a relatively simple one with a twofold division in so far as capital is concerned.

To suggest the imposition of income bonds on the management and board of the Canadian National, which consider that common stock is necessary, I say would be a denial of what is properly a matter for the exercise by the Canadian National directors of the discretion accorded to directors of any corporation with respect to the declaration of dividends and the handling of any surplus

which may be available. Similar to the C.P.R., the legitimate aim of the management of the Canadian National Railways on its own part is the attainment of financial self-sufficiency. That is an objective which it believes merits earnest consideration in the making by this Commission of its recommendations upon this all-important matter which is presently before it. The C.N.R. says that it wants to be allowed to handle this particular aspect of things in the same way that the C.P.R. does.

That is all I have to say on that aspect. We consider that the proposal as put forward is fair and reasonable in every respect, that it provides very simple treatment in the final analysis for the recording on the balance sheet of the capital of the corporation divided into those two categories.

I leave that and come now to one of the witnesses called by the C.P.R., Mr. Courtland Elliott, their third witness on this matter. As to Mr. Courtland Elliott I have very little to say. He was retained by the Canadian Pacific to examine the Canadian National recapitalization plan, and to use his words, "to peruse the evidence given before your Commission in connection with that plan."

The following sentence expressed by him indicates why it is considered well to make but a passing reference to his testimony. Mr. Elliott said:

"This request was made" --

That is the request by the C.P.R. to him.

" -- with a view to placing before you whatever comments I might develop, not as an expert in railway finance or operations," --

I emphasize those words, "not as an expert in railway finance or operations, but rather as an outside observer with a detached

approach to the subject at hand."

That is in Volume 114, page 20815. In our respectful submission, and with every deference, I say that Mr. Elliott's approach was so thoroughly detached that there is no point in considering Mr. Elliott's remarks in detail.

"The subject at hand" as Mr. Elliott put it, is one which in the final analysis is so very technical and requires such an intimate knowledge of railway operations and railways financing, that the best expert opinion in railway finance and railway operations should be sought in attempting to deal with it. On Mr. Elliott's own frank admission he is, in our respectful submission, not qualified to bring any experienced judgment to the solution of the problem. He stated he had been retained "to peruse the evidence". As far as I am concerned, the Commission has heard the evidence and seen the witnesses who have spoken to the facts involved in connection with it. It is the Commission that has to be the judge of the matter, not one who has merely read the evidence.

As indicating our reasons for refraining from any review or discussion of Mr. Elliott's evidence, I would respectfully direct the attention of the Commission to a statement which he made on page 20818 reading:

"On the basis of the information available, there is a considerable area of doubt in my mind whether the specific difficulties cited by the Canadian National Railways are basically due to its disproportionate amount of funded debt and to a large amount of unremunerative investment."

He further indicated that there was doubt in his own mind that, and I use his words, "the predicament

of the Canadian National Railways may not be so serious or so permanent as is contended." That is at page 20819.

As to these remarks of Mr. Elliott, I say only that all through the years numerous persons with first-hand detailed information, the Duff Commission, Senate and Commons committees, have said that the Canadian National's debt burden was excessive, that it was over-capitalized, and so on. The C.P.R., Mr. Walker, Mr. Evans and its witnesses, Mr. Northey Jones and Mr. Norman, all agree that it is excessive. In effect they have stated that the only thing that worries them is the remedy which is to be brought to rectify the situation. All are in agreement except Mr. Courtland Elliott, and alone in his opinion I leave him.

I said yesterday that the Canadian Pacific called but three witnesses to express their views on the merits and consequences of our recapitalization proposals. None of them was experienced in railway operations. These witnesses were introduced as an investment banker, a chartered accountant and an economist. Whether by design or quite by accident, the Canadian National witnesses who had previously explained its proposals to you are primarily a banker, an accounting officer and an engineer possessed of considerable knowledge, I think it may fairly be said, of railway economics.

The Canadian Pacific witnesses have not hesitated at any point to defer to the superior knowledge of the Canadian National witnesses concerning this recapitalization problem, which after all is one so specifically related to the Canadian National itself, so integrated with it and woven into its own operations and affected by conditions and characteristics peculiar to it alone.

To point up the fact that the Canadian Pacific

witnesses avowed that the Canadian National witnesses, its own officials, were better qualified than they, by experience and training, and by reason obviously of their close contact with its affairs, one has but to refer to a few short excerpts from the evidence which, with your permission, I propose to do.

First as to Mr. Northey Jones, Mr. Jones said:

"I am neither an engineer nor an accountant."

That is at page 20424, Volume 112. Again he said:

"I have not inspected the Canadian National."

That is at page 20514, Volume 112.

Speaking of the surpluses which might result from the recapitalization, the following questions and answers indicated the deference of Mr. Northey Jones to the opinion of the Canadian National officers in this respect. I refer to page 20491, Volume 112.

"Q. As I say, then, from your point of view your theory is that there may be large surpluses?

"A. Well, I hope there will be considerable surpluses over and above ^{the} \$15 million.

"Q. Now, the Canadian National as you know are not optimistic; they say that on this recapitalization on the average the surplus will be zero.

"A. Well, they ought to be able to forecast that better than I can, much better."

Similarly, regarding estimates as to the growth of traffic and its potentialities, the following short passages indicate that in Mr. Northey Jones' judgment the views of the Canadian National auditors concerning this all-important subject should prevail. I refer to pages 20595 and 20596, Volume 113.

"Q. With respect to growth of traffic in Canada I think you said very fairly and frankly that in so far as Canadian National is concerned you are prepared to leave that to the judgment of the officers of the Canadian National who have full information and details concerning that?

"A. Yes.

"Q. And whose judgment you thought was better in the circumstances?

"The Chairman: What is it that Mr. Northey Jones is prepared to leave to the discretion of the management?

"Mr. O'Donnell; His estimate as to the growth.

"The Witness; The estimate of the growth of traffic for the Canadian National."

Then again he said:

"Then I think somebody asked and I then said that as to actual details of estimates of the volume of traffic which will move in the 1950's the officials of the Canadian National are much better able to estimate than I as to what that volume will be."

Then again:

"Q. But, in any event, getting back to what I have in mind, we agree that the economy in Canada is on a different level; we have a different level of freight rates, for instance?

"A. Correct.

"Q. Different levels of remuneration for labour, and we have different prices throughout our entire price structure?

"A. That is correct.

"Q. And now with respect to truck competition you say you have more of it in the United States and I assume that is correct, as at this point, but you are aware of the fact that truck competition in Canada has grown tremendously in the last few years?

"A. Yes.

"Q. . . . I thought that the officials of the Canadian National were better able to estimate the traffic potentialities than I was.

"A. Well, that is good enough for my purpose."

The question and the answer are inverted there and the witness is made to appear to be asking the question whereas he was answering. So much for that.

From a perusal of this evidence and a consideration of the tenor of other answers given by Mr. Northey Jones during his examination, I submit that it is fair to say that he speaks of the Canadian National affairs without any real knowledge of them, and that his views with respect thereto are without weight, as he admits, particularly when they are in contradiction to the considered, experienced judgment of the Canadian National witnesses.

One might comment that the formal statement made by Mr. Jones, when commencing his evidence, is but argumentative and speculative and in no wise factual. If my count be right, thirty-three times in the course of his statement the word "if" appears and seven times the phrase "it would seem".

The study and consideration of the Canadian National proposal was given from the point of view of the banker, on the other hand, by Mr. Gordon. His qualifications to speak on such matters I leave to the appreciation of the

Commission. It should not be forgotten, however, that in connection with his study and in the formation of his opinion and judgment, Mr. Gordon had available to him all the detailed data and technical personnel fully acquainted with every aspect of the Canadian National's affairs and operations. I simply say this is in sharp contrast to the sole opinion of Mr. Northey Jones, who quite honestly admitted, and whose evidence is quite clear, that he is in no position to bring any considered judgment to bear on the problem.

As to Mr. Norman, in my submission the various statements very frankly made by him likewise indicate that any knowledge which he may have of the Canadian National recapitalization problem and its affairs generally is wholly insufficient to permit him to be of any real assistance to the Commission in the solution of this difficult subject.

While Mr. Norman enjoys the reputation and standing of a respected member of his profession, his knowledge of railway matters generally, I submit, cannot be compared with that of Mr. T. H. Cooper. As to Mr. Norman's knowledge of Canadian National affairs, its operations and figures, he readily admits it is of the most superficial nature, whereas Mr. Cooper has testified before you that he has devoted his business life to the affairs of railroads, and has spent about forty years with the Canadian National and its predecessor companies. I think Mr. Norman would be the first to acknowledge that Mr. Cooper would fully qualify as an expert on the subjects which he discussed before you.

To begin with, Mr. Norman frankly stated that he was not a railroad expert, Volume 113, page 20701. Again he said:

"I am not a student of the economics
of railways."

That is at page 20702. At page 20621, in reply to Dr. Innis when questioned as to there being a parallel between the C.N.R. and the C.P.R. with regard to the position of their equipment he said:

"I have not checked any of the C.N.R.'s figures, because I have no knowledge whatever of how they are computed."

Again his sparse knowledge of the Canadian National System is indicated when, being questioned regarding his proposed segregation of non-paying railways, and being referred to the Newfoundland, Temiscouate and the Hudson Bay Railways, he stated in reply to Mr. Covert at page 20650:

"Mr. Covert, I do not have sufficient information in regard to the Canadian National."

Mr. Norman referred to the need of a valuation of the earning power of the Canadian National as at this time. His evidence acknowledges that he made no such study, and that the Canadian National officers have so done. (Volume 114, p. 20801-2).

Obviously Mr. Norman concedes that the views of the latter concerning this subject must prevail as against any statements which he may have expressed on the subject, when so wholly lacking in any detailed knowledge of it.

It will be remembered that Mr. Norman stated in the course of his formal submission that:

". . . in order to gauge as to what should be the financial structure of the railroad it would be necessary to have the following information."

That is at page 20639 of Volume 113. At that page Mr.

Norman listed four items of information which he thought he would like to have concerning these matters. When cross-examined he acknowledged that his suggested method of approach to the problem was but one way of dealing with the subject, that there were numerous ways, and he agreed that it might be handled in other ways, including that proposed by Mr. Gordon of the C.N.R., which would avoid the lengthy delay entailed in Mr. Norman's own method and have equally beneficial results. He admitted that the four items of information which he suggested he would like to have would require a lot of time and study to obtain, and that it would delay matters very considerably in so far as reaching any solution to this particular problem.

The following excerpts from his evidence make the matter most clear. I refer to Volume 114, page 20902.

"Q. . . . Mr. Norman, would or could not we agree that possibly you have suggested one method of handling the problem, as appears on page 116, and maybe Mr. Gordon's proposal and that of the C.N.R. is another method of handling the problem?

"A. That is correct.

"Q. And they might in the final analysis work out something that might not be too far apart, probably, after you had all the information?

"A. I think that is quite possible.

"Q. The matter, though, as I see it, is that with respect to yours, your manner of handling it, it involves a lot of delay and a lot of study in a detailed and specified

way that can be disposed of possibly on the basis that Mr. Gordon has handled it, at this time, and without that long, lengthy time of delay?"

The pertinent part of his answer was "Yes". Again at page 20805, and I have taken the part of the question that deals with the matter with which I am concerned. In the question there was reference to other matters but the part that I think is the question begins at the top of page 20805 and reads:

" . . . Are you so definitely of the view that this problem could not be handled until these additional studies that you suggest could be made?

"A. I am not saying as to 'they cannot be handled.' I am saying that if the problem were given to me those would be the things I would want to know.

"Q. That is the way you would do it?

"A. That is my view.

"Q. But you do not say somebody else might not do it in another way with equally beneficial results?

"A. That is probably true.

"Q. And there may be a shorter way of doing it than the way you suggest?

"A. There are all kinds of ways of approach to a problem of recapitalization.

"Q. That is right."

It is our submission that as to the extent of the adjustment required and the method of handling it, Mr. Norman is not, due to his lack of familiarity with the problem of the C.N.R. from the financial and

operating aspects, in a position to bring any reasoned judgment to bear on the problem.

At this point I should like to refer to the Duncan Commission. I think that the Duncan Commission was faced in a way with a somewhat similar situation in so far as working out a solution to a very detailed problem that might have been approached from a scientific and detailed aspect in so far as study is concerned, and arrived at a practical, reasonable solution.

(Page 24121 follows)

The problem, I think, in so far as this one that we have before this Commission is concerned, is somewhat kindred, and could be treated in a similar way.

Mr. Norman says, "Now, if I were doing it I would want all this detailed study, data," and that would take a long time to get and that would delay this thing. This Commission is requested to report, and in my submission there is ample evidence on the record to deal with it in about the same practical over-all way that the Duncan Commission did at the time.

Now, the Duncan Commission adopted an expedient which I think, and which they said, had the purpose of giving immediate relief in a manner that is equitable as well as broad, and I say that the problem might be approached in a similar way here. The Commissioners there said, near the bottom of page 22:

"We do not believe -- and the Canadian National Railways have informed us that they also do not believe -- that any more accurate or equitable result could be obtained by minute and scientific investigation, which would, in any event, take an indefinite time to conduct. The situation is one that can only be dealt with in a broad spirit, and one that for the economic welfare of the Maritimes must be met without delay. The course we suggest has the effect of giving immediate relief in a manner that is equitable as well as broad."

And again:

"We think that this broad measuring, once and for all, of these considerations has such decided advantages that it should not be qualified or delayed by minor criticisms."

Substitute the Canadian National Railways for the

Maritimes, and I say the statement of the Commission is very apposite and provides a reasonable way for solving the problem with which this Commission has to deal. It is on that basis, facing the difficulties of any arithmetical exactitude, that the Canadian National approach the problem, and it suggests that the settlement which is proposed would be "equitable as well as broad", and it would also permit the matter to be handled, as is contemplated, I submit, by the terms of the reference in this case, expeditiously and without doing violence to anyone.

When considering the evidence which the Commission has before it, I would just ask the Commission to have in mind the experience and qualifications of Mr. Cooper, which will be found in volume 98 at page 18462. I do not want to take too much time, but, for the convenience of the Commission, I would just like to have it neatly on the record at this point:

Almost forty years with the Canadian National or its predecessor companies; its chief accounting officer, and before that successively General Auditor, Assistant Comptroller, and since 1938 Comptroller and since 1945 Vice-President & Comptroller. Since 1923 he has been pretty much in charge of the final accounting at Headquarters for the Canadian National System.

A statement of Mr. Fairweather's experience and qualifications will be found in volume 103 at page 19106: A man of forty years' railroading experience, and I think he is as fully qualified as anyone in Canada to speak on the subjects concerning which he speaks. His record and experience were stated briefly by me as follows (p. 19106):

" . . . Mr. Fairweather has been engaged in railroading since 1911. He is a graduate of Acadia and McGill

Universities in Civil Engineering. He was on the staff of the organization set up by the Government to conduct the Grand Trunk Arbitration, and on the consolidation of the Canadian National in 1923. He was appointed Assistant to the Director, Bureau of Economics, of the Canadian National, which department was subsequently changed to the Department of Research and Development, of which Mr. Fairweather has been Vice-President since 1943."

COMMISSIONER INNIS: They do not look that old.

MR O'DONNELL: No, they are very young-looking and well preserved.

MR EVANS: They probably feel that way.

MR O'DONNELL: I think if they had to stay through this kind of session very many more times they would soon get to look most old.

Mr. Cooper and Mr. Fairweather have throughout the years, I say, appeared before all the important bodies investigating railway matters; and I respectfully submit that their evidence can be relied on with confidence by this Commission.

That is all I have to say on that point, and I turn now to the question of the desirability of adjustment of the capital structure and the adoption of the C.N.R. plan.

On this aspect of the matter, Mr. Cooper said (vol. 99, p. 18557):

"It is safe to say that this matter of recapitalization has been under consideration on and off since 1917, a period of over thirty years. There has been general agreement that the railway's debt structure is far too heavy and that something should be done about it, but there has been a tendency to leave the

problem for someone else, or for another day."

Again, Mr. Cooper reviewed in detail the various references to the subject which have appeared in reports of Royal Commissions and other public documents over the years. He referred to the Drayton-Acworth Commission in 1917 (p. 18548).

The Commissioners there said, if you will remember, speaking of the Canadian Northern, the Grand Trunk and the Grand Trunk Pacific:

"These companies have broken down. We see no way to organize new companies to take their place. Their only possible successor is in our view a public authority. We are confronted with a condition and not a theory."

Then again at page XLVII (p. 18549):

"But if two companies went into the hands of receivers, we cannot doubt that investors outside Canada would believe, however, erroneously, that the Dominion Government had treated them badly, and that the result would be serious injury to the credit of the Canadian Government and indeed of all Canadian enterprises. And this result is one that, putting it on pecuniary grounds alone, the Canadian people should in their own interest spend a good deal of money to avoid. We therefore consider that Canada should assume the responsibility of seeing that the interest on these securities is met."

Then there was recommendation No. 28, which appears on page LXXXVII (p. 18549) -- I read that once before:

"That the Government assume responsibility to the Dominion Railway Company for the interest on the existing securities of the transferred companies."

The matter of an appropriate adjustment was broached by Sir Joseph Flavelle when, as Chairman of the Board of the Grand Trunk, he addressed a letter to the Right Hon. Arthur Meighen, Prime Minister of Canada, on August 12th, 1921. This letter appears in the record as Exhibit 220. One has but to read the recommendations of the then Chairman of the Board of the Grand Trunk to see that the relief suggested is still being sought.

The subject was raised again by the then Chairman and President of the Canadian National Railways, Sir Henry Thornton, in the Annual Report of the railway for the year 1923. The relevant extract from Sir Henry's report appears at p. 18551, vol. 99. It reads:

"Consideration is being given to the policy to be followed with respect to the capitalization of the system, and the extent to which, if at all, the advances made and capital held by the Government should be written down to a figure which may be regarded as consistent with the earning prospects of the railway. In the consideration of such a problem, the interests of the Government, which is to say the people of Canada, must be given due weight. On the other hand it would seem unreasonable to burden the Canadian National Railways with a load which is beyond its conceivable earning capacity."

Further reference was made -- I am merely putting these in chronological order so that they will be conveniently before the Commission -- further reference to this problem and the possibility of dealing with it was made when the well known auditing firms of Messrs. Edwards, Morgan & Company, and Peat, Marwick, Mitchell & Company, made a joint report to the Board of Audit in March 1925 (vol. 99, p. 18552) regarding the same recapitalization problem.

(Page 24126 follows)

The matter was raised again in part by Sir Henry Thornton and appears on the same page.

The problem still remained unsolved at the time of the Commission under the Chairmanship of the Right Honourable Lyman Duff, P. C. In September, 1932, when this Commission reported, it commented upon the excessive capital liabilities of the Canadian National Railways, but stated that it did not consider the time opportune to deal with the matter. Its reference to this matter will be found in paragraph 86 of the Report under the heading "Capital Structure - Canadian National Railways" at page 30 of the Report. Reference is made to it in two other paragraphs. Paragraph 84 says:

"Representations have been made with respect to the capital structure of the Canadian National Railways." And again at 85 it refers there to the problem:

".. is the total capital liability of the system.." And 86 says:

"It has been suggested that in view of the excessive capital liabilities in relation to the earning power of the system they should be reduced to an amount which more nearly approximate the earning power of the railway. The net operating income (i.e. the amount available for interest and dividends) of the Canadian National system for the period 1923-31 inclusive averaged \$24,414,447 per annum. This figure would require adjustment if adequate provisions were made for depreciation. It is obvious that on this basis of earnings the capital liabilities would require a very drastic writing down. And while this Commission is of opinion that it must be frankly recognized that a very substantial part of the money invested in the railways comprised within the Canadian

National system must be regarded as lost and that its capital liabilities should be heavily written down, they do not consider that the time is opportune to deal with this important matter."

The matter is again emphasized by the Commissioners in Paragraph 192 which appears at page 60 of the Report. It reads:

"The Canadian National system suffered under a heavy burden of capital liability and fixed charges with consequent unsatisfactory results of operations from the financial point of view."

All are in agreement that from the railway operational point of view, the Canadian National Railways today is efficient, well managed and is doing an excellent job but from the financial point of view, owing to the distortions in reporting the results, its true position is not properly understood and it suffers as a result of that. It is for that reason it suggests that at this time, after these many years of review and comment upon these matters, this situation should be adjusted.

A further very pertinent observation by the Commissioners appears in Paragraph 206 which is at page 64 of the Duff Report. I quote in part:

"...The debt of the system in the hands of the public is now very large and more than the railway can carry from its earnings even under improved conditions..."

I say the same situation prevails today. The debt of the railway is still far more than it can carry from earnings.

Some of the recommendations of the Duff commission were implemented by the Capital Revision Act in 1937. It should, however, be fully understood that it was but a partial treatment of the problem. Speaking of this Act, Mr. Cooper said and I read his few words at page 18556:

"All I want to say at this point is to emphasize that the Capital Revision Act of 1937 was never intended to be a cure for all the ills which beset the railway's finances."

THE CHAIRMAN: Who said that?

Mr. O'DONNELL: Mr. Cooper, my lord, and the Commission will remember that in the Main Brief at page 27 and following -

THE CHAIRMAN: Did he speak of the Act of 1937? Was that what he was referring to?

Mr. O'DONNELL: Yes, my lord.

THE CHAIRMAN: "is never intended ..."?

Mr. O'DONNELL: "to be a cure for all the ills which beset the railway's finances."

THE CHAIRMAN: What did the Act say about that?

Mr. O'DONNELL: Well, the act is summarized very neatly, I think, at pages 26 and 27.

THE CHAIRMAN: Where is the Act itself?

Mr. O'DONNELL: Well, the Act, mylord, is in that pamphlet.

THE CHAIRMAN: It might be well to look back and see what parliament thought they were achieving. I think I have it here. Yes, I have it here.

Mr. O'DONNELL: And it is something that you will have to read very closely and carefully and I would refer you to the schedules which are annexed to it in order that you may get the true tenor and import of it and reference is made to it in Exhibit 214, the Canadian National Main Brief at the bottom of page 26 and over on to pages 27 and 28.

THE CHAIRMAN: The Act does not seem to contain any declaration of intention?

Mr. O'DONNELL: Now, the Act does not, but I read, I think, the other day, extracts from the debates in connection with it, and I think, my lord, that for an easy understanding

of the general provisions, if your lordship would just look at pages 26, 27 and 28 of the Main Brief, you will see it there in summarized form but it is something that will have to be looked into by the Commission and I make merely this passing reference to the treatment of it by Mr. Cooper at the time he was testifying.

Mr. Cooper went on then to say at page 18556:

"The revision was related only to the relationship between the railway and the government as to the government's position as both shareholder and creditor. The railway has tried to make it very clear that the revision did not go far enough. It was so stated by the Board of Trustees of which the late Honourable Judge Fullerton was chairman.

The Board of Trustees was later superseded by a Board of Directors, and when asked for their views the directors passed the following minute."

They were asked by the government for their views concerning the passing of the bill and the Minute No. 22, January 21, 1937, reads:

"Further consideration was given to the draft (dated January 6, 1937) of the proposed Bill entitled 'An Act to Provide for Revision of the Accounting Setup of the Canadian National Railway System.'

It was unanimously resolved that the Directors approve the policy of the same Bill.

They desire to add that they reserve the right to recommend additional measures when they have had time and opportunity for a more detailed study of the capitalization and general financial position of the System.

Acknowledging receipt of this resolution, the Minister of Transport said: (It was a letter):

Ottawa, January 25, 1937.

Dear Mr. Hungerford: (He was the then president)

Thanks for yours of January 21st, to advise that your directors have approved the policy of the draft bill providing for revision of the accounting setup of the Canadian National Railways.

Your directors will of course have the right at any time, to recommend additional measures along the same lines.

Yours faithfully,

(sgd.) C. D. Howe (p18557) "

That is the end of the quotation of Mr. Cooper's comments.

During the course of his remarks to the Standing Committee on Railways and Shipping Owned, Operated and Controlled by the Government, On February 18, 1937, the Minister of Transport said in part:

"... no steps however were taken in 1920 to provide for adjustment of the capital liabilities on the National Railways' balance sheet ..."

On the same occasion the Honourable Minister also said:

"...The National railways has in the course of events become an integral part of the financial structure of Canada. It cannot now be properly considered as something independent and apart. In view of the funded debt in the hands of the public, the position of the Dominion is, in the final analysis, essentially that of equity ownership regardless of how the problem is approached and this fact might well be made clear to the people of Canada in the published accounts of their railway."

And again I quote:

"It has been said that the conversion of any interest-bearing government loans for capital purposes to proprietor's equity represented by capital stock would be unfair to the Canadian Pacific, which company

has to raise its capital requirements at interest."

It is curious to note how oft and regularly repeated -- as and whenever the Canadian National endeavours to do any 'internal housekeeping' with a view to presenting its affairs in a more easily understandable way to its shareholders, the people of Canada - does the Canadian Pacific raise the cry "unfair". History repeats itself.

THE CHAIRMAN: We will now have a five-minute recess.

-- Recess.

(Page 24132 follows)

THE CHAIRMAN: Very well, Mr. O'Donnell.

MR. O'DONNELL: Yes, my lord. I just notice here that on that statement that has to go into the record, the word "surplus" appears on the end. That obviously should be "deficit".

THE CHAIRMAN: What is that?

MR. O'DONNELL: This \$122,000, instead of being "surplus" it should read "deficit". That is a mistake.

Now, just picking up where we were before the adjournment, I would like to say that the capital burden of the Canadian National was also the subject of inquiry by the Special Committee of the Senate of Canada, which convened in 1939, and the report of the Committee at page 490 contains the following observation. I have already read part of the observations of that Committee, my lord, the part at page 490 I won't read again. But at page 492 the Committee said this in its report, its report dated 11th May 1939:-

"In the opinion of some members of the Committee the emphasis which has been placed upon Canadian National deficits has from the outset of the inquiry placed our National Railway System in a somewhat false position before the public, who, previous to this inquiry had no comprehensive knowledge of the development of the Canadian National System and the service it has rendered to the country. Unfortunately its debt and deficits seemed to stand as an indictment against its administration, and although Canadian Pacific business was also on the down grade and was

"fighting its own battle, its contribution before the Committee focused entire attention upon Canadian National Railway deficits as though they were the cause of all our railway troubles. The psychology of this situation placed the Canadian National Railways in the position of having to defend and justify its administration."

Now, that is exactly that time of thing, I say, that should be remedied once and for all and for the relief of which the present proposals are put forward.

THE CHAIRMAN: You say "once and for all". What do you mean by that.

MR. O'DONNELL: I mean, once and for all in so far as anything can be. Today this problem, which has been hanging around for so many years, should be treated and an attempt should be made to dispose of it on a reasonable basis, remedying the type of thing that the Senate report refers to, and to put the company in a position so that its true operating results as of today and in current times, are reflected and reported and readily understandable by the public. That is what I mean by that.

I submit, the Duff Commission said "We know it is there, it is over-capitalized, the burden is excessive, but it is not the time to deal with it". Now, I submit, is the time, and ^{all}/I am saying is that we are asking in the circumstances, we will expect and ask for a recommendation from the Commission which will permit that matter to be settled in so far as it is possible to settle any problem. That is what I have in mind there. Now, my lord and members of the Commission, under the provisions of Section 13 of the C.N.-C.P. Act,

independent auditors were appointed. I might read it if it would be of any assistance.

THE CHAIRMAN: All right, we know it.

MR. O'DONNELL: That provides that a continuous audit of accounts of the National Railway shall be made by independent auditors appointed annually by joint resolution of the Senate and the House of Commons and annually reporting to Parliament in respect of their audit. "Their annual report shall call attention to any matters which in their opinion require consideration or remedial action." That is the pertinent part so far as I am concerned at this point. The pertinent provision, I say, reads: "Their annual report shall call attention to any matters which in their opinion require consideration or remedial action."

Now, in compliance with their duty, these auditors have repeatedly reported that the fixed charges of the railway are excessive and disproportionate, and have indicated that they should be adjusted. In 1944 they said (and I quote):

"We would also make mention of the disproportionate amount of fixed charges borne by the National System in comparison with other major railways in North America."

In 1946 they reported:

"The ratio of fixed charges to operating revenues was 11.7 per cent. We would again call the attention of Parliament to this disproportionate ratio of fixed charges as borne by the National System in comparison with other major railways in North America."

In 1947 the auditors said, at page 5 of their report:

"The ratio of fixed charges to operating revenues was 10.5 per cent. We would again

call the attention of Parliament to this disproportionate ratio of fixed charges as borne by the National System in comparison with other major railways in North America."

And again at page 12 they stated that the System has afforded some indication of "a peace-time earnings potential despite certain handicaps from a strictly competitive and economic standpoint which were existent at the time of amalgamation and still^{are}/adherent in some of its operations.

" Looking to the future, these inherent operating handicaps, in our opinion, might well be made the subject of a special study with a view to determining the effect on operating results of those services of a national character as distinguished from those of a normally competitive character. From such a study the Railway enterprise and its Management policies could be more equitably and effectively evaluated than is possible under the present basis of viewing the operating results "

And I say that those are the remarks --

THE CHAIRMAN: Have you finished reading?

MR. O'DONNELL: Yes, my lord, I had just finished.

THE CHAIRMAN: I think we know now where the language of this particular clause in the Order in Council comes from.

MR. O'DONNELL: I think so, yes.

THE CHAIRMAN: I mean, the comparable --

MR. O'DONNELL: That is where it comes from, I think.

THE CHAIRMAN: Have they gone on in that report

or elsewhere to explain just what they mean by comparable basis?

MR. O'DONNELL: Not that I know of, my lord.
I think they take for granted --

THE CHAIRMAN: Their report has been tabled?

MR. O'DONNELL: Three or four times.

THE CHAIRMAN: Who are the auditors?

MR. O'DONNELL: The auditors are Touche & Company, a very well known firm of auditors. At different times through the years there have been other auditors -- Clarkson, Gordon and Dilworth & Company were the auditors at one stage, but Touche & Company have been the auditors for quite some years now. They are appointed independently by Parliament; they are not the company's auditors. They are independent auditors appointed, in the words used in the statute, Section 13: 'a continuous audit of the accounts of the National Railways shall be made by independent auditors appointed annually by joint resolution of the Senate and the House of Commons, and annually reporting to parliament in respect of their audit.'

THE CHAIRMAN: Now, do you think, Mr. O'Donnell, that by reading their report or their several reports, it may be, we can get to a proper understanding of what is meant by this clause in the Order in Council, Clause C of paragraph 2?

MR. O'DONNELL: Well, on that I don't know, my lord.

THE CHAIRMAN: "Establishing and maintaining the fixed charges of that company on a basis comparable --" on a basis.

MR. O DONNELL: Yes, my lord.

THE CHAIRMAN: "Comparable to other major railways in North America." No doubt the language of

this clause in the Order in Council came from these reports.

MR. O'DONNELL: I think that the Order was issued by reason of the repeated --

THE CHAIRMAN: I mean, the very language.

MR. O'DONNELL: I agree.

THE CHAIRMAN: In part at least. They act by comparison with revenue and so on.

MR. O'DONNELL: Through the years, having had the matter drawn to the Government's attention so frequently as it has been drawn --

THE CHAIRMAN: Have these reports been put in evidence? Have we them?

MR. O'DONNELL: Well, they are readily available. I have a set that I would be glad to let the Commission have.

THE CHAIRMAN: We should have them, of course.

MR. O'DONNELL: Oh, yes. I shall be glad to have them. I think Mr. Covert says that the Commission, its accounting officer, has a copy. I think we furnished copies of the financial accounts of the company itself and the auditors at the outset of the Commission's work. Mr. Covert agrees that that is correct.

I say, my lord, that those are the remarks of Parliament's independent auditors, not auditors appointed by the Canadian National Railways. In 1949 at page 1 of their report they said:

"In our reports of previous years we have commented on certain matters to which we do not propose to refer in this report in view of the appointment of the Royal Commission on Transportation."

The problems to which the auditors referred are those which are presently under consideration here.

Now, apart from the references which I have given to the many places and the many times at which this problem of the Canadian National's excessive capital debt burden has been raised, I think it might not be amiss to draw the attention of the Commission to the very pertinent statements of Mr. Northey Jones at page 20490 and Mr. Norman at page 20642. I won't take up the time of the Commission to read those, but I just draw your attention to them. Mr. Norman's was a very short quotation, however. He says -- and I quote in part --

" . . . there may be some merit in the C.N.R. request that the total fixed charges be reduced to provide greater flexibility and to avoid deficits in periods of reduced traffic."

Mr. Northey Jones likewise agreed that he thought that this company should have an adjustment, and he said:

"I know I would not want to see recurring deficits in a company in which I was one of the managers."

Now, similar expressions were voiced by Mr. George . Walker, chairman of the Canadian Pacific Railway Company, appearing before the Commission on December 12 last, when he said -- pages 13370-5 -- and I quote in part only:

"I repeat what we have said publicly before, that the Canadian National Railways is today ably managed by a thoroughly competent group of officers; and it should also be said that the Executive Officers of the Canadian National presently serving the system cannot be charged with responsibility for the depressing picture disclosed in their submission."

"We appreciate too the feeling of lowered morale which it is suggested must affect officers and employees of the Canadian National in serving a railway which, to put it briefly, does not pay its way. Indeed in recent years the inability of the Canadian Pacific to earn adequate revenues (while gross earnings were at the highest level in its history) has produced a like feeling on the part of its officers and employees, differing, if at all, ^{only} in degree, from that of the officers and employees of the Canadian National."

The Commission will remember, I think, that I drew to Mr. Walker's attention what he obviously had not intended to infer, in any event, that the Canadian National had never had an operating deficit; that when it is suggested that it does not pay its way, the meaning there is that it does not pay its way when this excessive capital burden is saddled on to the operating results in each given year. Only then does it not pay its way, but it has been paying its way so far as its operations are concerned in each and every year since it was set up, and that is what should be very fully clarified.

Again, as further evidence of the notoriety of the situation concerning the unbalanced capital set-up of the Canadian National, I refer to the formal submissions of the Province of Manitoba to this Commission (Exhibit 119), which at page 68 refer to "The Capital Charges and Corporate Structure of the C.N.R." where it is expressly stated that:

". . . the capital structure of the C.N.R. based as it is upon a reorganization of a number of bankrupt or near bankrupt lines, is such that

its fixed charges are far in excess of those for comparable railways on the North American Continent."

The submission goes on to state at Page 69:

"At this point we would like to refer parenthetically to subsection (c) of section (2) of Order in Council P. C. 6033 which directs your Commission to consider whether it would be advisable to establish and maintain the fixed charges of the C.N.R. ' on a basis comparable to other major railways in North America'.

"The reference in this subsection is to fixed charges alone. It is our view that any reorganization of the financial structure of the C.N.R. must take into account a number of other things of which one is the element of current operating expenses which represent the losses on uneconomic lines. Another is the peculiar position of equity capital in the C.N.R. when compared to privately owned lines. We do not propose to discuss these matters further in this present submission except to express the view that the mere scaling down of the fixed charges of the C.N.R. without regard to the other factors, would be far from a satisfactory solution of the financial problems of the C.N.R.

(Page 24141 follows)

"Our views with respect to the financial position of the C.N.R. and with respect to the position of the C.N.R. in the determination of the level of Canadian freight rates, should not be interpreted to mean that we think the C.N.R. should be ignored in these matters. The C.N.R. is a major factor in Canadian transportation. In miles of track, in tonnages moved, in number of employees and in nearly all measures of size, it far surpasses the C.P.R. The standard of service offered by it compares favorably with the C.P.R. and in many aspects of its operations its practices and experiences follow closely those of the C.P.R. Careful attention should therefore be given to its operations and its results will be of great assistance in estimating the cost of many specific services."

As I have said, my lord and members of the Commission, the provinces of Canada which have been represented at the hearings have generally approved the idea that the time is ripe for an adequate adjustment of the long-outstanding problem of the C.N.R.'s capital structure.

THE CHAIRMAN: That is just the point. In your brief at pages 30 and 31 it seems to me that you undertake to show why the settlement of 1937 was not adequate; that is so, isn't it?

MR O'DONNELL: Yes, my lord.

THE CHAIRMAN: You talk then about the advisability of securing a final and complete solution.

MR O'DONNELL: Yes.

THE CHAIRMAN: And that you think is what this plan gives?

MR O'DONNELL: Well, yes.

THE CHAIRMAN: Because, you see, you exercise a

great deal of ingenuity to show that, after all, it is rather a precarious plan.

MR O'DONNELL: I exercise a great deal of ingenuity to show what?

THE CHAIRMAN: That this is, after all, rather a precarious plan.

MR O'DONNELL: Well, my lord, I say that the plan is based on actualities and facts as they are today. Now, the Commission is not, any more than I, a prophet of what the situation may be ten years hence or twenty years hence, but as of today the situation is -- and I think it is factually before the Commission -- as it was put by the evidence that was led here, and that is the problem to be approached from the facts as they are; and the facts as they are, in my respectful view, are, I think, well established, and I do not think the Commission is expected to deal with the thing on the basis of what they may be fifty years hence. In 1916 there was a commission, in 1931 there was a commission, and there have been committees of the Senate inquiring into these matters year in and year out, and committees of the House of Commons. Time goes on and situations change, but all the Commission can be expected to do is to approach the problem as it presents itself today on the basis of actualities as they are at the present time, and that is what has been put before the Commission -- the problems of the Canadian National as they today exist. That is all that the Commission is asked to study and report on and recommend about, and that is all that can fairly be expected of the Commission. The Commission would not be held responsible twenty years hence for something that may occur in the interval. That is the way we approach the problem, my lord, and we say that the situation as it is today is what has to be faced and dealt

with, and we say that this is the first Commission, the first tribunal, that has been set up to deal specifically with this particular problem. The Duff Commission was set up to deal with---

THE CHAIRMAN: Yes, I know. That adds force to the thought I had in mind, that you were suggesting something, as you call it there, final and complete.

MR O'DONNELL: Well, when I say final and complete, my lord, it is as final and complete as the Commission could recommend on the situation as it is today; that is what I have in mind.

THE CHAIRMAN: Well, all right, Mr. O'Donnell, we will do the best we can.

MR O'DONNELL: Well, I think, in my respectful view, that we have a very substantial case, supported by facts and figures that speak for themselves, and with that problem squarely before the Commission it will be up to the Commission to determine how it handles the situation and what recommendations it will make.

I simply say again that when I speak of dealing with the problem once and for all, I mean with the problem as it presents itself at this time. If the problem changes twenty-five years from now, there will undoubtedly be another Commission. Apparently Royal Commissions are things that go on through the ages from time to time, and I do not think that this will be possibly the final Royal Commission on even railway matters; but this Commission can reasonably be expected, I think, to deal with the facts as they are at this time, and that is all that it can be reasonably expected to do.

I say what the Canadian National is proposing today is in conformity with the views of those who at its inception foresaw the great place which it would come to

hold in the transportation field in Canada. In 1919, when the bill was proceeding through Parliament, the Hon. Arthur Meighen then said of the C.N.R., in part:

"We are trying to operate it as a business concern under corporate management."

That was his view.

Mr. Bureau, who I think was later Postmaster General, said in that same debate, on April 23, 1919:

"This bill is being passed for the purpose of putting the Canadian Government Railways as nearly as possible, the interest of the people being protected, on the same footing as all privately - owned railways."

The Hon. Mr. Rowell, who was then President of the Council, said on April 25th in that same debate:

"I stand for public ownership and operation of this railway system, expanded and enlarged until it is made a thoroughly complete system, able to compete on equal terms with the Canadian Pacific Railway."

I have already referred to the expressions of view of the Right Hon. Mr. Bennett, Mr. Ralston and Sir Thomas White.

THE CHAIRMAN: Is your idea the one that Mr. Rowell expressed on that occasion? Is that a fitting way to put it?

MR O'DONNELL: I think that is the future that he forecast for this railway, and I say that as to railway operations that has come true. As to railway operations, we are competing on even terms, and sometimes with better results even in one year or another, but generally speaking on even terms in so far as railway operations are concerned with the Canadian Pacific; but we are constantly beneath that cloud of deficit by reason of something which the

present management is not responsible for. That is all we are asking be removed. That is not an unreasonable request, in our view.

THE CHAIRMAN: Don't you show on page 30 of your brief why that cloud should not be there?

MR O'DONNELL: I think we try to show in many places, my lord, why it should not be there. Page 30 deals with a portion of the problem, that is true, but we have shown, we think, why it should not be there. We have called witnesses to explain why it should not be there; we have put evidence before the Commission, in my respectful view, as to why it should not be there.

I refer to the Drayton-Acworth Commission, which said, in my interpretation of it, that the interest charge should never have been against the railway as such, it should have been assumed by the Dominion. Why should we have had to run it through our books year in and year out, as we are doing? It was never intended, in my view, that it should be done that way. All I am saying is that today what Mr. Rowell foresaw as being the outcome of this publicly-operated road has arrived, and in so far as railway operations as such are concerned it is able to compete on equal terms with the Canadian Pacific Railway. As far as its financial picture is concerned, it is at a very considerable disadvantage.

THE CHAIRMAN: Isn't it at the root of your case that you never should have had these burdens imposed on you?

MR O'DONNELL: That is right, my lord; we never should have been charged originally with the interest on the \$804 million of securities which were taken into the corporation at the time of its inception. The Drayton-Acworth Commission said, "We do not recommend bankruptcy for these companies. We recommend that they be turned over

to a new public authority, the Dominion Railway Company," which when it was incorporated became the Canadian National by name; but the further recommendation which goes with that was that in lieu of bankruptcy the Dominion should assume to the exoneration of the railway company the interest on the securities of the transferred companies.

Now, I say that we should never in the circumstances have had that debt on us. In the interval since 1923 the burden has been increased from time to time, for instance through the imposition -- when I say imposition, I should say the entrustment of the Newfoundland Railway without adequate allowance for its operation, through having to provide capital expenditures for the Government Railways and pay interest when we are merely agents for the Government, and the Government had never prior to turning them over to the Canadian National charged interest on those things. All those items add up to \$1,533 million -- having to provide rolling stock for the Canadian Government Railways, having to co-ordinate those four different systems into one integrated system as it is today, having to find the money to do that and having to pay the interest on the money when found. We say that all those things have to be and should be taken into account on any proper adjustment of our capital structure. We have the total of \$1,533 million, and the witnesses who were here, Mr. Fairweather and Mr. Cooper, said it is conservative, and they showed you why it was conservative. They showed you where, for instance, they had taken figures and then reduced them by ten per cent to be on the safe side. The claim is not padded or exaggerated at all. And they say as at this time, taking into consideration the fact that the railway has potentialities for earning,

we will not ask for complete dollar treatment of this matter. We are prepared to make an adjustment on the basis that would provide relief to us from interest-bearing charges of \$1,060 million. If you allow us that relief we will endeavour to operate this great enterprise with the hope that on the average we will not have to report deficits. We may have surpluses in some years, we may have deficits in others, but our best considered experienced judgment is that we will on the average not have a deficit, if you just give us the relief we suggest we are rightfully entitled to ask for. And when your lordship says that the root of the case is that these burdens should not have been imposed, I agree entirely; that is our case; they should never have been imposed to the extent of \$35.6 million, I think it is, of interest in the first case.

THE CHAIRMAN: I suggested that was the root of your case, but I was not undertaking to decide anything about it.

MR O'DONNELL: I know that, my lord. I am not endeavouring to suggest that you have given judgment of any kind. I am simply saying that in discussing this thing you say to me, "Well, isn't that the root of your case?" I say, yes, that is the root of my case, but the roots have picked up through the years certain additions to their branches as they grew, and we have these other burdens that we went over, the various lines operated in the national interest and these other items.

My lord, the heading that I have these notes under is "The desirability of adjustment of the capital structure and adoption of the Gordon plan." That is on the little chart that I gave your lordship at the outset of the discussion.. I am on that point, and all I am endeavour-

ing to do here is to put in a convenient place on the record the chronological sequence of events and the expressions of opinion of people who, understanding the facts and knowing the situation, have repeatedly, year in and year out, said this should be adjusted. It should, but to date it has not been, and the Commission here, in my view, is charged with the duty of recommending what should be done in the circumstances.

Now, as recently as May 11th, 1950, the House of Commons Sessional Committee on Railways and Shipping Owned, Operated and Controlled by the Government in its Report to the House regarding the Annual Report of the Canadian National Railways for 1949, as part of its said Report, made this significant statement -- and that report was this morning filed as Exhibit 290:

"The Annual Report was adopted, but your Committee recommends that the earliest possible consideration be given to the recommendation of the President of the Canadian National Railways that there be a reorganization of the capital structure of that system."

That is the most current expression of view.

In conclusion on this point, I would respectfully refer the Commission to the section of the Main Brief (Exhibit 214) at pages 75-79, under the heading "General Desirability of Adjustment" where aspects which are not strictly financial are put forward as additional reasons for adjustment at this time. These pages were read into the record, and for further reference will be found in vol. 98, commencing at page 18456 and running to page 18459.

CONCLUSION

By way of concluding this all-important part of the Canadian National Railways' submission to your Commis-

sion, I can think of no better way so to do than to read the words addressed to you by Mr. Gordon when he appeared before you on March 17th last. His closing remarks for which I solicit your respectful consideration will be found at page 18388, vol. 98. They are as follows:

"It is my considered opinion, concurred in by the Board of Directors, that nothing short of these measures can be deemed adequate treatment of the capital structure of Canadian National. These measures, if put into effect, should enable Canadian National, on the average, to meet its fixed charges, including interest on funded debt.

"I submit very earnestly that the adjustment of the capital structure of Canadian National is long overdue and that for the reasons set forth in the Submission filed by Canadian National with you in October last, as well as for the further reasons already presented and to be presented during the course of these sittings, your Commission should recommend that it should now be adjusted."

With confidence I leave this most important part of the Canadian National submission to you, sincerely trusting that your deliberations will result in a recommendation that will ultimately culminate in the adjustment of the capital structure of the Canadian National which is anxiously awaited by so many who are interested in Canada's greatest transportation agency.

That is all that I have to say on that aspect or branch of the problem, my lord.

Now, there is one other matter to which I should like to refer, and that is the request concerning the treatment of the Canadian National Railways securities trust. I think it might at this point be well to refer to

that.

THE CHAIRMAN: What statute set that up?

MR O'DONNELL: The Capital Revision Act of 1937, my lord. The Capital Revision Act of 1937 provided for the Capital Revision Act.

Now, as part of the recapitalization problem or proposal, and for the purpose of simplifying the capital structure, the accounting procedure and the balance sheet, this proposal, which stands on its own merits and which is quite severable from the proposals concerning the reduction of fixed charges and the other adjustments requested, seems altogether unobjectionable. Reference to it will be found in the Main Brief at pages 181-184.

Mr. Cooper explained the proposal very clearly in his testimony (vol. 100, pages 18644-49). He testified as to the purpose for which the trust was created, what the securities trust is -- in reality an accounting device -- what the suggested revision proposes to do, and what the result will be if it is carried out.

With respect to the purpose for which the securities trust was created, Mr. Cooper said at page 18644:

(Page 24153 follows)

"The trust was an arrangement incidental to the 1937 Capital Revision Act. The government had agreed that loans for deficits should be cancelled, that all unpaid interest should be cancelled, and that government loans which had been made for capital purposes should be converted into equity capital. The various corporations, The Grand Trunk, the Grand Trunk Pacific, the Canadian Northern and the Canadian National Railway Company, were indebted to the government for very considerable sums of both principal and interest. These amounts then appeared as liabilities on the system balance sheet. It was desired that as far as the railway system balance sheet was concerned, the loans for deficits and all unpaid interest should be eliminated. At the same time it was intended that the four debtor corporations should not be freed from their liabilities in respect of principal and interest referred to.

To some extent the claims of the government ranked ahead of other obligations of the four companies, and certainly they ranked ahead of the common shares of some of the subsidiary companies in which the public had a minority share interest."

THE CHAIRMAN: Are you reading from your Brief?

Mr. O'DONNELL: I am reading from the evidence, my lord:

"The problem therefore was to make an arrangement which would relieve the railway system of the liabilities in question but which would not relieve the separate corporations which comprised the system. The arrangement decided on was the creation of a trust corporation to which the government transferred its claims against the debtor corporations in exchange

for the capital stock of the trust. There was no relief to the debtor corporations but the creditor became the trust instead of the government. The government's ownership of the claims become indirect, that is, through the trust."

Now, at page 18646 Mr. Cooper told the Commission what the Securities Trust is:

"The securities trust, as stated in the main submission is a corporation created by Section 12 of the Capital Revision Act. Its entire capital stock is held by the Minister of Finance on behalf of His Majesty. There are five trustees, three representing the government and two representing the railway. The government trustees are the Deputy Minister of Finance, The Deputy Minister of Justice and the Deputy Minister of Transport. The railway trustees are Mr. Donald Gordon, chairman and president, and myself (this is Mr. Cooper speaking). The Capital Revision Act stipulates under what conditions the initial stated value of the Trust Shares may be increased or decreased. It may be increased by capital gains and by surplus earnings retained by the railway. It may be reduced by capital losses which are excluded from cash settlements on deficit account."

And he goes on then to give the details of what was in the Securities Trust at the time. I do not think the Commission is interested particularly in that. But then he goes on to say in reply to this question:

"What is it that you propose to do, and what will the result be if it can be done?"

A. What is now proposed is that ownership of the shares of the trust shall be transferred by the government to the railway company in exchange for an equal

number of railway company shares having the same ledger value. If this is done the railway's ownership of the shares as an asset account would be offset in the consolidated balance sheet against the capital stock liability of the securities trust. That is to say, both the asset and liability accounts would be eliminated from the system balance sheet, and the affairs of the securities trust would all be within the family and would not appear on the system balance sheet.

The equity capital owned by the government would then all be reflected on the railway balance sheet as capital stock of Canadian National Railway Company. This proposal, if made effective, would consolidate the government's equity in Canadian National into two accounts instead of three. At present there are three accounts: (1) Capital stock of the Canadian National Railway Company; (2) Capital stock of Canadian National Railways Securities Trust, and (3) Capital expenditures by the government on Canadian National Railways.

Under the proposal number 2 would disappear. The advantage from this arrangement is that it helps to simplify our capital structure. The Securities Trust would not appear, and the capital now represented by the shares of the trust would be represented by shares of the railway company. The government's ownership would not be diminished in any respect but would be entirely through the railway company instead of being partly through the railway and partly through the trust. Very few people understand the interjection of the securities trust in the capital structure of the Canadian National, and this arrangement would

help to a better understanding."

And then he went on to say:

"The debts of the four corporations will remain exactly as they are, and will still continue to be held by the trust. Transactions affecting the government's equity capital account will continue to require government approval. The collateral securities held by the Trust will continue to be so held subject to release only with the approval of the Governor in Council as required by Section 21 of the .Act."

And then he went on to say that this matter had been discussed with the government and, I take it, that they had no objection to this matter being dealt with as is suggested.

by
I think that the evidence given Mr. Cooper and the explanation in the Main Brief make the reason for this suggested change quite evident.

THE CHAIRMAN: Did I understand you to just say that the government had approved of it?

Mr. O'DONNELL: The officers who were on the Securities Trust agreed that the matter should be put before the Commission here.

THE CHAIRMAN: I thought it went further than that.

Mr. O'DONNELL: I have just forgotten offhand. I will read this on page 18648:

"This matter has been discussed with the government trustees, referring to the Deputy Minister of Justice, the Deputy Minister of Finance and the Deputy Minister of Transport. While they do not consider that they should express their views as to what government policy should be, they are satisfied that the railway shall include the subject in its submission to the Royal Commission requesting the Commission's favourable consideration and recommendation."

Well, I thank you very much, my lord and members of the Commission, for a very patient and attentive hearing which you have given me and my friend Mr. Friel will proceed with certain other aspects of our case.

COMMISSIONER INNIS: One point which I would like to raise, Mr. O'Donnell. It is a little unfair as you are no doubt exhausted after this effort.

Mr. O'DONNELL: Well, I am still standing.

COMMISSIONER INNIS: I am wondering as to the effect on public opinion. Will not this mean that the Canadian National Railways will be looked upon by the public as a yardstick? That is, people will say: "Well, after all, it is breaking even. Therefore, it must be reasonably prosperous?"

Mr. O'DONNELL: Well, I do not think, Dr. Innis, that that is likely and, further, in so far as the fixing of rates is concerned, as I said at the outset that is understood by everybody in Canada now to be the business of the Board of Transport Commissioners. They have been given considerable publicity over the last three or four years as being the rate-fixing body and as and when the railways get before that body, that body understands the situation and is in a position to act. It was set up for the purpose of being a buffer, as I see it, between public opinion and the railways.

COMMISSIONER INNIS: I am thinking of the man on the street who does not know about the Board of Transport Commissioners. All he sees is that the Canadian National has broken even or has made a profit and he therefore thinks that things are in a reasonably satisfactory position and he does not understand why all this rumpus is being raised about rates and so on.

Mr. O'DONNELL: If we broke even, we would only be permitted to do so on the basis as it stands at the present time that the Canadian Pacific Railway would likewise have what it required because to date (and we have not asked for any change in that) - to date the requirements of the Canadian Pacific are met and it is our view that the Board of Transport Commissioners, so long as it is essential that the Canadian Pacific should be kept as a railway transportation agency in Canada, will set see to it that it gets what it needs and we certainly do not think that there is anything like the disadvantage that there would be with the situation being in the reverse where we have these tremendous deficits reported which the man in the street also does not understand.

COMMISSIONER INNIS: But I am thinking that you are apt to have a general feeling that this is a situation designed to meet a series of averages over a period of years, or , as you put it this morning the year 1950 becomes a sort of sacred year in which you will break even. Now, that presumably will change if the emphasis on morale is correct. The morale will be so improved that the earnings will very greatly increase?

Mr. O'DONNELL: A certain amount will be reflected, I imagine.

COMMISSIONER INNIS: And your position will consequently be rather better than what is indicated in the reliances on the averages that you put forward and does not that mean that you are going to be very much more of a yardstick in public opinion than would otherwise be the case?

Mr. O'DONNELL: Well, that I think -

COMMISSIONER INNIS: You cannot discount, of course, this effect on morale?

Mr. O'DONNELL: No, and you cannot discount the matter of the difference in traffic density and all those other problems either. We have always got that difference on the evidence of about \$20,000,000 in between us and the other railroad, and, in the final analysis the Board of Transport Commissioners, in my view, having been set up to weigh those things, the public - such part as is interested, in any event - would have to inquire as to the reasons. The Board itself, of course, would understand the reasons and I do not envisage any danger to the Canadian Pacific in so far as giving us on our own merits what we say we are entitled to by way of an adjustment.

Now, if as a result of that adjustment, as I said earlier, somebody thinks that it is affected or can establish that it is affected, then other remedies are open there but all we are asking for is an adjudication on our case on its merits fairly and not with the thought that someone in the remote future possibly (we do not think there is any possibility of any adverse effect on the other company) but even if there is, I say then with respect, that when they arise they will be dealt with as fairly, I hope, as we expect to be dealt with here by way of recommendations.

COMMISSIONER INNIS: I want to push a little further your reference to the Board of Transport Commissioners. This revision will presumably mean greater independence of power. It means you become much more malleable from the standpoint of management itself. Presumably you will have surpluses to play with or deficits or whatever it is that are involved and consequently what might be described as "national policy", that is to say, a very broad airing outside the Board of Transport Commissioners and outside the control of parliament either through

deficits of the Canadian National or through special legislation and so on - but that object is appreciably narrowed and I am wondering whether the whole suggestion does not mean that parliament will have to be much more alert to the sort of problems in that field once you have narrowed your position and once you have indicated that you are not so dependent on the views of parliament as you have been?

Mr. O'DONNELL: Well, Dr. Innis, all I would say there is that the Commission, in making its recommendation and report, could admonish parliament or try to remind the people if it be a deficit but I would point this out: We have not asked for removal of the fetters which parliament has imposed upon us as to the manner in which we expend moneys. Now, I think that is the thing that is pointing up this whole problem unless I misunderstood you.

COMMISSIONER INNIS: I understood you. My concern is with this broad ~~airing~~ ^{airing} which is outside the Board of Transport Commissioners' jurisdiction and which will be, I think much more outside it once you have come rather more under the jurisdiction of the Board of Transport Commissioners and rather less ^{under} the jurisdiction of parliament.

Mr. O'DONNELL: Well, I don't know, Dr. Innis, whether I understand.

COMMISSIONER INNIS: It really concerns this definition which you term "national policy" which is something vague but which is important.

Mr. O'DONNELL: But the position, Dr. Innis, is that parliament has placed the national railways as fully under the control of the Board as the private railways and in so far as the matter of what we can or cannot do is concerned, we are treated identically the same as the

Canadian Pacific Railway before the Board.

COMMISSIONER INNIS: But now parliament could come along and put additional roads on you?

Mr. O'DONNELL: They could still. If they built the road and entrusted it to us, we would bargain with them or try to just as we will be on the submission here. We would try to get a fair deal if they were going to ask us to bear a burden and we are not asking that that be changed.

COMMISSIONER INNIS: Just one other minor point. I am a little bit confused as to these various figures. One figure - \$804,000,000 for example; what would be the position, for example, of the excess expenditures of \$173,000,000 on the National Transcontinental? Is that registered in that \$804,000,000? One could think of various - call them extravagances or due to corruption or whatever you like - which are registered in some way and I wonder if you have ever made an attempt to isolate those. They are such peak expenditures that one might have thought that they would be worthy of some special attention.

Mr. O'DONNELL: I think, so far as we approached the problem, Dr. Innis, we took the situation as it was at the time we got the roads.

COMMISSIONER INNIS: You have never looked into that?

Mr. O'DONNELL: No, what had happened before that we could not help and were not accountable for or responsible for. We said at the time our company was formed had we been dealing at arm's length with the liquidator or receiver, we certainly would never have paid the amounts that were carried into the account for these roads. We would have looked into all these things. We had no option; they were put on us and even the Intercolonial.

COMMISSIONER INNIS: Take the Transcontinental itself there, an excess of \$173,000,000 which is the item at the original estimate?

Mr. O'DONNELL: Well, the National Transcontinental and the Intercolonial Railway were taken in without any charge because they were without any.

COMMISSIONER INNIS: That is what I was wondering about.

Mr. O'DONNELL: I think that is the situation but the \$804,000,000 - we are talking of the Grand RTrunk, the Grand Trunk Pacific and the Canadian Northern. That is what the \$804,000,000 relates to.

COMMISSIONER INNIS: Only those?

Mr. O'DONNELL: Yes.

COMMISSIONER INNIS: That is the point I was confused about. I thought you said the National Transcontinental was linked up?

Mr. O'DONNELL: They were entrusted afterwards. By P. C. 115 they were entrusted for management purposes after.

COMMISSIONER INNIS: But the \$804,000,000 relates only to the Grand Trunk, Grand Trunk Pacific and Canadian Northern?

Mr. O'DONNELL: Yes.

COMMISSIONER INNIS: Not including the National Transcontinental?

Mr. O'DONNELL: That is my understanding and that the National Transcontinental and the Intercolonial Railway were entrusted by virtue of P. C. 115 after the claim was set up and there was no claim advanced for those.

Thank you very much.

---- At 1.05 p.m. the commission adjourned until 2.45 p.m.

Ottawa, Ontario,
Friday, May 26, 1950

AFTERNOON SESSION

ARGUMENT BY MR. FRIEL

MR FRIEL: May it please the Commission:

I propose to deal with the balance of the topics of the Canadian National. They are not many in number, and I do not expect to be long.

THE CHAIRMAN: You have not a written outline?

MR FRIEL: No, my lord. I can give you the topics.

THE CHAIRMAN: That is all right.

MR FRIEL: I am starting off with Agreed Charges.

Your lordship will recall that we proposed an amendment to the Transport Act, section 35, which perhaps I might read into the record. We take the present section 35 right out of the Transport Act and substitute a new section 35 reading as follows:

"35. Notwithstanding anything in the Railway Act, or in this act,

(1) A carrier may make such charge or charges for the transport of goods of any shipper or for the transport of any part of his goods as may be agreed upon between the carrier and that shipper. Provided that when the transport is by rail from or to a competitive point, or between competitive points on the lines of two or more carriers by rail, such competing carriers by rail shall be permitted to enter into the negotiations and shall have the right to join in making the agreed charge."

THE CHAIRMAN: What meaning is there to the word "carriers" there?

MR FRIEL: That would be carriers to whom the Act is applicable, which would be rail carriers and water

carriers. Air carriers were taken out of the Act, my lord.

"(2) A duplicate original of the agreement setting out the particulars of the agreed charge shall be filed with the Board within seven (7) days after the date of the agreement, and the agreed charge shall become effective thirty (30) days after the date of such filing.

(3) Any shipper who considers that his business will be unjustly discriminated against if an agreed charge is made by the carrier, or that his business has been unjustly discriminated against as a result of the making of an agreed charge, may at any time apply to the Board for a charge to be fixed for the transport of his goods (being the same goods as or similar goods to and being offered for carriage under substantially similar circumstances and conditions as the goods to which the agreed charge relates) by the same carrier with which the agreed charge is proposed to be made, or is being made, and, if the Board is satisfied that the business of the shipper will be or has been so unjustly discriminated against, it may fix a charge (including the conditions to be attached thereto) to be made by such carrier for the transport of such goods.

(4) The Board, in fixing a charge, may fix it either for such period as it thinks fit or without restriction of time, and may appoint the date on which it is to come into operation, but no such charge shall be fixed for a period beyond that for which the agreed charge complained of by the shipper has been published.

(5) All agreed charges shall contain a cancellation clause giving either party the right to cancel the agreement upon specified notice."

THE CHAIRMAN: You will point out now the changes?

MR FRIEL: Yes, my lord, as I go on.

The matter of agreed charges is dealt with in our main submission (Exhibit 214) at pages 171-181.

THE CHAIRMAN: Pardon me. Are you leaving anything of the original section 35?

MR FRIEL: Well, parts of it are the same, my lord. The wording of the first section, for instance---

THE CHAIRMAN: You see, the original section 35 is much longer than this draft of yours.

MR FRIEL: Yes, my lord. We are deleting several subsections in section 35.

THE CHAIRMAN: You are adding?

MR FRIEL : No, deleting.

THE CHAIRMAN: You are leaving what is there now?

MR FRIEL: We are deleting, taking them out, my lord.

Agreed Charges were first authorized in Canada in 1938 by the provisions of the Transport Act, 2 Geo. VI, chapter 53, Part 5, sections 35 to 39 inclusive. These charges were designed to meet truck and water competition, the former in a larger degree of course than the latter, inasmuch as truck competition was the more serious of the two and presented greater hazards to the railways for the future. Mr. Fairweather in Vol. 109, p. 20118 stated:

"I would not say that the erosion of railway net by water competition is a serious thing at all; I do not think it is because actually water competition is mostly limited to those commodities that move in bulk and the water shipper, broadly speaking, is sharing with the railways the job of moving the basic commodities of the country at extremely low prices.

There is some competition that, in my opinion, is uneconomic but I do not think it is serious. The

really serious nub of the thing is the uneconomical highway competition."

Mr. Fairweather when asked for the solution stated that while restrictive legislation was not the answer, making the agreed charge more effective and flexible was one practical suggestion. (Vol. 109, p. 20121).

Mr. Fairweather developed his ideas in this regard (Vol. 109, p. 20139). He explained that every railway rate in Canada is inter-related and that shippers and the public, generally, do not realize that a rate, for instance, on pulpwood moving from a forest area to a pulp mill is actually related to the movement of an automobile. The low rate cannot exist without the higher. The railway rate structure is of necessity founded on such relationships. Anything which weakens the rates on the higher valued traffic tends to destroy the railways' ability to function and to carry the low valued and low rated traffic. Shippers are free to pick and choose. They can use the railways for their low valued traffic and the truck for their high valued traffic. In doing so, however, they are hacking at the rail rate structure and practising discrimination against the rates for low valued traffic which must be kept available for the primary producers. One cannot blame the shipper for picking and choosing, for this works to his immediate advantage. The railways, however, must counteract this by all possible methods if the present rate structure is to be sustained and if they are to preserve themselves in an economy in which they are vital.

Much consideration has been given to this problem. Various methods have been suggested for meeting it -- some more drastic than others. One suggestion has been the penalizing of pickers and choosers by denying to them the

advantages of the lower rate unless they also use the higher. A more flexible agreed charge, such as is proposed by the Canadian National, is a compromise solution. It must be remembered that the truck competitive situation in 1938 while serious for the railways has become much more serious since. Restrictions which may have been justified then are not, it is submitted, justified now. It was never expected that the railways would encounter such protracted delays in making their agreed charges effective. Such delays have seriously hampered the effectiveness of the agreed charges and discouraged the railways in the use of them. As it is stated on page 171 of our main Submission, the shortest time in which an agreed charge has been put into effect after submission to the Board has been 34 days, and the longest time one year and 10 months.

On pages 177 to 179 of our main Submission we have explained the stultifying effect of the decision of the Privy Council in *Canadian National Railways vs. Canada Steamship Lines*, 58 C.R. & T.C. 113, where it was held that the Board was not precluded from regarding as a relevant consideration the probable effects of an agreed charge on the business and revenues of other carriers. If such consideration were to govern in competitive rates generally, there would be no such rates.

The most intense highway competition occurs in the general area between Quebec City and Sudbury. There is also effective water competition in respect to package goods. Railways in meeting truck competition may affect the revenues of the water carriers -- not, we would submit, in any substantial degree. Why should an adverse effect on the revenues of water carriers be a consideration in approving an agreed charge? The railways must submit when

their revenues are affected adversely by reason of the same water carriers' competition. Any possible damage done to water carriers is insignificant in comparison to the damage done to the revenues of the railways by the unregulated and uneconomical competition of highway transportation.

Our proposed amendment, as redrafted and filed with this Commission, is designed to eliminate delay and free the railways from unnecessary and hampering restrictions. It is designed to give them free and unfettered use of a practical and admitted weapon to meet such unregulated and uneconomic competition with a view to assisting the revenue position of the railways and preserving the present rate structure under which they function.

THE CHAIRMAN: Does your amendment intend to strike out the whole of the present subsection 1 of 35? You see, I am a bit astray, because you head this "Amended sbustitution for section 35 of the Transport Act", but you do not tell us what parts of the present 35 you are striking out, amending or---

MR FRIEL: Well, I develop that, perhaps somewhat sketchily, as I go along, my lord. We could pick it out section by section if you wish. For instance, we have eliminated an important clause there:

"The Board shall not approve such a charge if in its opinion the object to be secured by the making of the agreement can, having regard to all the circumstances, adequately be secured by means of a special or competitive tariff of tolls under the Railway Act or this Act."

THE CHAIRMAN: You are striking that out?

MR FRIEL: We strike that out, my lord, and we also qualify the last part of the first section, which

provides further that when the transport is by rail from or to a competitive point or between competitive points on the lines of two or more carriers by rail, the Board shall not approve an agreed charge unless the competing carriers by rail join in making the agreed charge.

THE CHAIRMAN: I take it, then, that your proposed subsection 1 would repeal the present subsection?

MR FRIEL: Yes, my lord.

THE CHAIRMAN: And be a substitution for it?

MR FRIEL: Yes, my lord. Instead of making it necessary for both carriers or two or more carriers to join in the making of an agreed charge, we now provide that such competing carriers by rail shall be permitted to enter into the negotiations and shall have the right to join in making the agreed charge; that is, they have the right to negotiate and the right to enter into the agreed charge, but an agreed charge cannot be held up by the reluctance of one railway to go along with the other.

THE CHAIRMAN: I notice that the present Act says "Notwithstanding anything in the Railway Act ". You do not put those words in; you think you can do without them?

MR FRIEL: No, my lord, we have that.

THE CHAIRMAN: Oh, pardon me, you have it at the beginning.

MR FRIEL: Yes, we have it at the beginning.

THE CHAIRMAN: Yes, the whole thing, not only that subsection 1. All right.

MR FRIEL: The proposed amendment eliminates Board approval and with this elimination also goes any question as to whether special or competitive tariffs would accomplish the purpose sought. Filing is preserved. Why should Board approval be required in what, after all, is merely another form of competitive rate? If a competitive or special rate

would secure the objective (to hold or get back the traffic), why should the railways concern themselves with an agreed charge? Such considerations, it is submitted, can safely be left to managerial judgment.

Our proposed amendment would also eliminate the present subsection 3 of Section 35, which requires that an agreed charge shall be made on the established basis of rate making. It is our submission that the carriers should be free to make such charges as may be agreed upon with the shipper, without being restricted to the established basis in which there is no magic. The main consideration is the improvement in the net revenue position.

(Page 24172 follows)

The railways should be free to carry all of the shippers' traffic for an agreed sum, the same as truckers are free to do now, in the more intensive competitive years and in the same manner as the water carriers can do now in respect of bulk goods and could do with packaged goods in the proposed amendment which applies equally to water carriers. There is no such restriction in the British Act.

THE CHAIRMAN: Then, you would strike out Section 2 altogether, would you?

MR. FRIEL :Yes, my lord.

THE CHAIRMAN: I notice Section 36 at present says:

"The agreed charge shall be expressed in
cents per hundred pounds."

and so on. Is there any virtue in that? Of course, you are throwing it overboard?

MR. FRIEL: I say, my lord, that there is no magic in the established base of rate-making. There is no reason why we should not go to the shipper and figure out what his traffic costs are and undertake to carry a similar amount of traffic at a lump sum cost after analyzing it and seeing what the cost is to us and how we can improve our revenue position.

THE CHAIRMAN: What was the idea of the present statute? For instance, it says:

"The carload rate for one car shall not exceed the
carload rate for any greater number of cars".

Was there any reason for that?

MR. FRIEL: Well, it just perpetuates the provisions of the Railway Act, as I understand them, my lord, that they shall pay the same rate for all and why that should be -

COMMISSIONER ANGUS: Is that meant to protect the

small shipper?

MR. FRIEL: Well, it may protect the small shipper in a sense but the small shipper is not protected on his l.c.l. shipments. He pays more for those than his rivals who can ship by carload.

THE CHAIRMAN: Anyhow, you would cut all that away?

MR. FRIEL: That is right, my lord. The right of a shipper who considers his business will be unjustly discriminated against is preserved insofar as he may apply to the Board to have a charge fixed for the transportation of his goods subject to the conditions set by the Board. There is removed the right of such shipper or the right of any representative body of shippers or the right of any carrier to oppose the coming into effect of an agreed charge. There is preserved under Section 36 the right of complaint to the Minister of Transport by any representative body of carriers which considers that its business is placed at an undue or an unfair disadvantage. The Minister may, if satisfied that in the national interest the complaint should be investigated, refer such complaint to the Board for investigation. It is submitted that the shipper is adequately protected by the proposed subsection 3 and that the other carriers are adequately protected by the present Section 36.

THE CHAIRMAN: I see this that the complainant instead of going directly to the Board must first go to the Minister and the matter gets to the Board only if the Minister thinks it is worth-while?

MR. FRIEL: That is right, my lord:

THE CHAIRMAN: And you leave that as it is?

MR. FRIEL: We leave that as it is.

COMMISSIONER ANGUS: My recollection is that a good many people speaking on behalf of small shippers in the

course of these hearings have been told that no one was ever excluded from the fixed charge agreement because of the small scale of the shipments. I do not think that meant that he got carload rates if shipping in smaller than carload lots.

MR. FRIEL: No, the small shipper could have a charge fixed for himself or the small shipper could have an agreed charge for himself. All he has to do is apply for it. The railways are just as much interested in his \$300 or \$400 a year as they are in the bigger shipper who has \$3 million a year - There are a lot more small shippers.

COMMISSIONER ANGUS: This amendment, in appearance at least, leaves out that it assured the small shipper that he would get the same effective rate for his shipments if he was shipping one carload as a bigger shipper who was shipping five or six. Is he not protected in that way?

MR. FRIEL: I would say he is protected in this way. The small shipper can apply to have a rate fixed for him and, while the Board, in the past, has imposed the same terms on a shipper of small quantities as a shipper who enjoyed the agreed charge, there is no obligation on the Board to do that. The Board can fix a smaller rate for him if they see fit and if they think that would meet the justice of the situation.

COMMISSIONER ANGUS: He gets his protection from the Board - not from the statute?

MR. FRIEL: That is right. Objections are raised to agreed charges generally by the Provinces of Manitoba and Alberta, and, it is submitted, without a proper appreciation of either the issues involved or the nature of the statutory provisions. These Provinces have made much of the contention that general increases are borne by the non-competitive and long haul traffic in contrast to the competitive traf-

fic and the dangerous tendency in this regard for the future.

While the railways admit the danger, it is strongly denied that that is the situation today. Competitive rates have been greatly increased, in many instances in excess of the general increases and many competitive rates no longer exist as such, for instance the grain rates in the east. As traffic is lost to highway competition, the burden must be carried by all rates including competitive rates. Where the inconsistency of the Provinces comes in is in opposing a practical method of holding traffic to the rails and of regaining lost traffic. They would have their cake and eat it too. They complain of the burden of high rates but refuse to regulate the transportation agency which they control, not appreciating that low uneconomic truck rates erode the high value railway traffic and make impossible the continuance of the low rates on low valued traffic.

Manitoba in its argument (Vol. 119, p. 21553) finally went so far as to ask that agreed charges be abolished entirely. In this it departed from the position it had taken in its printed Brief at page 122 Vol 45 p. 8751. There it was stated that the system of agreed charges has led to misunderstanding and ill-will between groups of shippers and between shippers and the railways. No evidence was adduced in support of this statement and none could be adduced. Actually, there has been a minimum of friction.

Another point stressed was that when an additional 15 per cent increase was applied by the railways to competitive rates, no such increase was applied to agreed charges. Actually the majority of agreed charge contracts made provision for general increases.

It must not be forgotten that a contract is involved and, apart from its terms, is not subject to unilateral action

on the part of the railways. In addition, some shippers with agreed charge contracts threatened to cancel them if higher increases than 21 percent were imposed. In such cases the railways had to weigh the pros and cons and either omit the increase or submit to cancellation. Many contracts were increased 21 per cent and then 8 per cent. A few shippers cancelled their contracts and the railways cancelled one contract. Two other were renegotiated. All in all the railways made the best deal possible to hold the traffic to the rails.

Manitoba's recommendation in its printed Brief that agreed charges should be subject to the criteria suggested by Mr. G. A. Walker, K.C., in respect to competitive rates is not open to objection and is followed by the railways in any event.

It is hardly conceivable that the railways would, against their interest, reduce rates further than is necessary to retain traffic. The cost of service by a highway operator is at least four times the cost of service by railway for traffic involving any considerable haul. The railways would never have an incentive to reduce rates much below highway costs. There would always be a comfortable margin over rail costs with any rate which might be put in to meet highway competition because of the 4 to 1 cost factor.

The criticism that only the larger companies can take advantage of agreed charges is unfair and unfounded. The best example to the contrary is the agreed charge in respect to lumber and forest products which was cancelled in May 1950. There were fifty shippers, large and small, who entered into this contract. The railways, in their own interest, will retain as many shippers to these contracts as possible, and under the proposed amendment (as under the existing Act) any shipper can apply to have a charge fixed

for himself. In these days of shippers' organizations, provincial interests, trade magazines, etc., it is absurd to suggest that only the larger companies can keep themselves informed and adequately assess their position.

Alberta has also requested that agreed charges be abolished, using the same "small shipper" argument. It is stated that discrimination is inherent in agreed charges, although nothing is adduced to support this charge. Actually there is nothing in the present Act as in the proposed amendment to prohibit the Board from fixing a lower rate for a shipper than the rate agreed to by other shipper or shippers, and there can be little doubt that the Board would do this in a proper case. One could argue a much better case for the small shipper who has to pay l.c.l. rates because his business is small and he cannot ship in carloads like his competitor the larger shipper.

The objections of the Canadian Automotive Transportation Association are at least understandable. They appreciate that an agreed charge is a weapon which might disturb their feast on the high valued traffic. It is referred to as a weapon which truly reverts to the law of the jungle in competitive warfare. Their terminology would be more apt to describe their own warfare.

As long as the trucks can do as they will in the matter of rates, it is indeed jungle warfare. Mr. F. R. Hume, Counsel for the Association, in Volume 118 at page 21339, refers to a large number of tank truck operators who were thrown out of employment when Agreed Charge No. 4 went into effect in 1939. We have found nothing in the record to substantiate this speculation. It would not be a speculation, however, to conclude that a great many railway employees have been thrown out of employment due to the loss of rail traffic to the truckers. Mr. Hume finally boils his objections down

to one thing - the inclusion in agreed charge contracts of the right of the shipper to use trucks. At page 21343 Volume 118, in reply to a question put to him by your lordship, he said:

"That is the only thing we are objecting to in the matter of agreed charges. The rest is none of our business."

If he had just said that - "The rest is none of our business" that would have been fine -

THE CHAIRMAN: Who said that?

MR. FRIEL: Mr. Hume, my lord, when you queried him about the inclusion in agreed charge contracts of the right of the shipper to use trucks. He said:

"That is the only thing we are objecting to in the matter of agreed charges. The rest is none of our business."

In other words, he is objecting to the railways doing what the truckers are free to do and what is only natural they should do in the absence of regulation. Whether they do it by express contract or through the persuasion of low enough rates, the result is the same.

Mr. Hume, in Volume 118 at page 21339, recalled to this Commission that the principle of agreed charges had been opposed by the Winnipeg Chamber of Commerce, the Anglo-Canadian Oils Limited, the Canadian Manufacturers Association and by the Canada Steamship Lines.

The Winnipeg Chamber of Commerce, in Volume 2 at page 133, stated:

"We believe that the Commission should institute studies in connection with what is known as agreed charges in an effort to determine if these are considered equitable. These agreed charges are rates lower than normal in return for some large shippers guaranteeing to forward a specific percentage

of their tonnage by rail and on account of the volume offered. This may work to the disadvantage of smaller businesses, and hence concentrate control of industry in the larger centres, particularly in the east."

This could hardly be called opppsition.

The Anglo-Canadian Oils Limited filed a Brief at the Commission's sittings in Winnipeg (Vol. 4 p. 485). Mr. R. J. Christian, General Manager, read the Brief. This company opposed the application for approval of an agreed charge between the Canadian National Railways, the Canadian Pacific Railway Company and the McColl-Frontenac Oil Company Limited; reported in 39 J.O.R. & R., the Judgment in which has been filed as Exhibit No. 4. Mr. Christian's criticism of agreed charges is based not so much on agreed charges as such, but on the fact that he was not successful in his opposition in the McColl-Frontenac Case. The Brief states in Volume 4, at Page 486 that:

"....it was proved before the Board there was no competition whatsoever".

This statement is contrary to the finding of the Board. Mr. Christian's company and other companies were perfectly willing to enter into an agreed contract, but not on the same terms as the McColl-Frontenac Oil Company. They did not wish to forego the use of trucks for part of their deliveries in the same manner. Mr. Christian, in his cross-examination in Volume 4, page 531 stated:

"I am not asking for a change in the law. I am saying that, when I get an agreed charge, then you, as my competitor, should be able to get exactly the same thing, provided you agree to the conditions and do exactly the same as I do. I have no idea about agreed charges or what they are for, or anything else."

It is because Anglo-Canadian Oils Limited would not agree to the same conditions that they opposed the application of the McColl-Frontenac Oil Company. Their opposition is rather one of disgruntlement than opposition to agreed charges as such.

The Canadian Manufacturers Association's Brief and evidence appear in the record in Volume 30 at pages 5700 to 5918. This Association also filed an additional submission dated March 14th, 1950. Mr. S. B. Brown, Manager of their Transportation Department, appeared for them. Their objection was that the agreed charge might result in discrimination (p.5782).

(Page 24182 follows)

Mr.Brown thought that the large shipper could go to the railways and get an agreement but that --

"The smaller man may not be able to get into that agreement at all, because he may not be able to give them the terms." (P. 5775)

If, in practice, the agreements had worked out this way, there might be some point to the association's alarm. The fact remains that the small shipper, who can negotiate an agreement if he desires, can also apply to the Board to have the benefit of an agreement made by a large shipper. Mr. Brown admitted that there had been no complaints, that is, none of his members as shippers had complained to the association (p. 5776). Mr.Brown agreed that the truckers do what the railways do under agreed charges, without any restrictions, and that the regulation of trucking should include the prevention of such things (p.5781). Until there are such regulations, the association, to be consistent, should not object to the railways meeting the truckers' competition in the same manner.

The submission of Canada Steamship Lines Limited was presented by Mr. Hazen Hansard, K.C. and together with Mr. Hansard's evidence appears in volumes 69 and 70. Mr. Hansard did not ask that the agreed charge provisions be abolished. He felt that they were justified as long as competing transportation agencies remained unregulated (p. 14308 of volume 70). His objections to our proposed amendments are that regulated carriers could employ agreed charges indiscriminately and without control and completely disrupt the established rate structure. A rate war would probably result between the railways themselves and the water carriers would be placed in an impossible position. A carrier could quote

entirely unremunerative rates and the lack of the present safeguards would enable one unregulated carrier to take unfair advantage of another.

It is obvious that Mr. Hansard is not concerned with unregulated carriers and his argument can give little comfort to Mr. Hume. Agreed charges, in so far as Canadian National is concerned, are designed to enable regulated carriers to meet the competition of unregulated carriers and this, in the main, means the competition of the truckers. Agreed charges could not provoke a rate war between regulated carriers any more than can competitive rates. Water carriers are only partially regulated. Their main traffic, bulk traffic, is excluded and there are other important exclusions. Their competition in that part of their traffic which is regulated is not significant. In respect to the unregulated portion they are free to make agreed charges and such an agreed charge could include their regulated traffic when the shipper is moving both kinds of traffic. In addition, as regulated water carriers, they are included within the scope of the proposed amendments. While they suffer some disadvantage from being unable to operate for four or five months, this is more apparent than real. Some traffic does not move during the closed navigation period; other traffic can be accepted and stored (as is done) until the season re-opens. It is agreed that water transportation is cheaper (partly by reason of free waterways, navigation aids, etc.) and has inherent advantages which must be preserved in the national interest.

It does not mean that it has any vested right in traffic, nor should it complain if a competing carrier can, on a compensatory basis (we would not make a competitive rate or agreed charge on any other basis) secure the same traffic. Between regulated carriers, service and cost

will be the determining factor in the shipper's selection of his mode of transportation. Surely it is only on the erroneous assumption that the railways will charge unremunerative rates that Canada Steamship Lines opposes the proposed amendment.

There has been but the one shipper, Anglo-Canadian Oils Limited, -- that was our friend Mr. Christian -- to register opposition before this Commission to our proposed amendment, and it is submitted, this opposition was based largely on disgruntlement. The Canadian Manufacturers Association, while representing shippers, has had no complaints from the shippers themselves. Does this not indicate that fears such as of unjust discrimination are unfounded?

THE CHAIRMAN: Did you a moment ago mention an amendment suggested by some association, just before that?

MR. FRIEL: No, well, Mr. Hansard, he did not object to the agreed charges as they are now. He objected to any unfettering of the regulations whereby the railways would have more freedom.

THE CHAIRMAN: I thought later on you said so.

MR. FRIEL: Manitoba finally came around to asking to have them abolished altogether.

THE CHAIRMAN: You just mentioned some association. It may been the Canadian Manufacturers Association.

MR. FRIEL: I didn't mention that they had asked for any amendment, my lord. They objected, as I said,

COMMISSIONER INNIS: Has Parliament ever made any statement about its views towards water transportation?

MR. FRIEL: Wwll, I understand when the proposed bill was debated that at one of the sessions that point of water carriers was raised, that it was objected to

by water carriers, and that the records of that particular instance, there just aren't any. Anyway, they over-rode the objections of the water carriers. It was never intended that the act would be interpreted in the way it was done by the Privy Council. I mean, that was not the intention of Parliament when it passed the bill, although you have got to go by what the act said.

COMMISSIONER INNIS: But you said something about "inherent" in the last paragraph, I think, or perhaps the second one.

MR. FRIEL: You mean, where they claimed that the unjust discrimination was inherent in the agreed charges?

COMMISSIONER INNIS: No, it was something about there being certain rights in water transportation.

MR. FRIEL: There I say that it is agreed that water transportation is cheaper and that is by reason of free waterways, navigation aids, etc., and has inherent advantages which must be preserved in the national interest.

COMMISSIONER INNIS: Now, has Parliament ever said anything about preserving in the national interest?

MR. FRIEL: They did in the Transport Act itself go this far. They said:

"It shall be the duty of the Board...."

THE CHAIRMAN: Where is that?

MR. FRIEL: Subsection 2 of section 3 of the main act, my lord, the Transport Act:

"It shall be the duty of the Board to perform the functions vested in the Board by this act and by the Railway Act with the object of coordinating and harmonizing the operations of all carriers engaged in transport by railways and ships, and the Board shall give to this act and to the Railway Act such fair interpretation as will best attain the object aforesaid."

COMMISSIONER INNIS: Is that not after the American statement of policy?

MR. FRIEL: No, it does not go as far as the American statement of policy.

COMMISSIONER INNIS: What date is that amendment, or is it ?

MR. FRIEL: It is not an amendment. It was passed with the act in 1938. It was amended because they had included aircraft before, but that was taken out in 1944.

COMMISSIONER INNIS: It does not go as far, you say, as in the United States, protecting water?

MR. FRIEL: No.

THE CHAIRMAN: Well, it says there:

"..to coordinate and harmonize the operations."
That may not be the same thing.

MR. FRIEL: In our submission ---

THE CHAIRMAN: Has that subsection 2 of section 3 ever been put to work, ever been interpreted?

MR. FRIEL: It was, yes, by the Privy Council, in the Canadian Steamships case, my lord. That was one of the ---

THE CHAIRMAN: The case you gave us a while ago?

MR. FRIEL: Yes, my lord. It was one of the reasons for the decision which we say is contrary to the intent ---

COMMISSIONER INNIS: They make no reference to trucks?

MR. FRIEL: No, trucks do not come under the act.

COMMISSIONER INNIS: I am wondering whether that might mean you would be exposed to retaliation from the truckers if you were to carry this too far, from the provinces representing the position of the trucks.

MR. FRIEL: In what sense?

COMMISSIONER INNIS: Control over licenses.

Anyhow, Alberta has already refused to give any licenses to government railways.

MR. FRIEL: I really don't think it makes much difference what the provinces do. They are not going to regulate, and if they do they are not going to regulate in an effective manner. We have no hope at all as to what they can do from the positive side any more than we have any fear of what they will do on the negative side. We can beat the trucks, everything else being equal, provincial governments or no provincial governments.

COMMISSIONER INNIS: You defy all comers?

MR. FRIEL: Right. If we did not have to worry about our marginal producers, Dr. Innis, we could put the trucks out of business in a week.

COMMISSIONER INNIS: Don't you think that is rather an exaggerated statement?

MR. FRIEL: Well, you can figure it out for yourself. Our average out-of-pocket cost is one cent per ton mile, and there is 3, 4, or 5, certainly no less than 3. If we brought our traffic down to an all-inclusive cost of $1\frac{1}{4}$ cents --

COMMISSIONER INNIS: I thought it just incredible to say that you could do away with all trucks and investments in roads, and so on.

MR. FRIEL: Well, we carry some traffic at awfully low prices, and we pick that up on the high value traffic. If we brought it down to an average, I feel confident no truck company could make it.

COMMISSIONER INNIS: You would probably be out of business before the trucks.

MR. FRIEL: No, well, that might be. It would be awfully tough on a lot of marginal producers. They would be out of business too.

As I said before, there has been but the one shipper, Anglo-Canadian Oils Limited, to register opposition before this Commission to our proposed amendment and, it is submitted, this opposition was based largely on disgruntlement. The Canadian Manufacturers Association, while representing shippers, has had no complaints from the shippers themselves. Does not this indicate that fears such as of unjust discrimination are unfounded?

I close my argument in respect of agreed charges by reading an excerpt from Mr.Fairweather's evidence in volume 109, commencing at page 20108 and continuing to page 20110:

"I understand, Mr. Fairweather, that you attach some very particular importance to the matter of agreed charges and that your company's views are set out in the pages that I have referred to -- pages 171 to 181?

A. Yes, that is correct. The agreed charge is, in my judgment, a most highly important aspect of the complex problem created by highway competition, and it is about the only means that the railway has of effectively meeting the competition afforded by the motor vehicle. The justification of the agreed charge must necessarily be a matter of broad national interest, and it is not because it is of advantage to the railway that it is being urged -- it is because the agreed charge is of advantage to shippers generally and particularly to those shippers who most need railway service because they have not anything else available, these people out on development branch lines who must depend upon the railway for their service and who, in the past, have been afforded service at less than cost because that cost was assessed against other traffic.

In so assessing, a condition was produced where the traffic became vulnerable to highway traffic operators and, notwithstanding the fact that the railway is only about one-third as expensive a medium of transportation as the highway carrier --" Mr. Fairweather brings it down a little there --

"--nevertheless, the highway carrier comes in and erodes the traffic. Now, when that happens, it throws a burden upon the whole railway transportation of the country, and that burden tends to fall

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"upon the chap who really needs the railway service.

The Chairman: You say at page 175 your agreed charge is now about \$5,000,000 per annum?

The Witness: Yes.

The Chairman: Q. Now, can you tell us what would have occurred if you had not had these agreed charges in operation?

A. Well, the chances are we would not have had the traffic.

Q. That would be \$5,000,000 less?

A. Yes, but the agreed charge principle which was introduced into the Canadian rate structure was copied from English procedure."

That does not quite bring together.

"Q. I noticed that.

A. But it has been applied in Canada with more cumbersome machinery and the railway finds it a very ineffective medium.

Q. You mean to say that the British system is less cumbersome -- they have more facilities for making these charges?

A. Yes, the British system is much less cumbersome than the Canadian.

Q. Pardon me, that raises a question. I do not know anything about it yet. In Great Britain, of course, they have government ownership of railways. Have they any Board that has to be applied to or that might be applied to in these questions of agreed charges?

A. Oh, yes, there is a Board similar in a good many respects to the Board of Transport Commissioners, but, broadly speaking, the main distinction is this, that in England, if somebody thinks that he is injured by

"an agreed charge, he can go to the Board and if can make a case, he can get an agreed charge applied to himself, but he cannot prevent the original agreed charge being applied. That is a matter very similar to a competitive rate.

Q. He cannot prevent the agreed charge between the original parties?

A. No.

Q. But he can apply to come in under it himself?

A. Yes, to get a similar one if he can show cause that he should."

THE CHAIRMAN: That is how you would have the law here?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Have you finished with that now?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Tell me, then, in this new subsection 1 of yours which you would substitute for the present subsection 1, you make a few changes there that are of some importance?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Have you discussed them?
For instance, in the first place you do away with the necessity of the prior approval of the Board, don't you?

MR. FRIEL: Yes, my lord, I have discussed that.

THE CHAIRMAN: Yes, and then, secondly, the act now says that the Board shall not approve an agreed charge unless the competing carriers by rail join in making the agreed charge. Now, you do away with that and put in its place "such competing carriers by rail shall be permitted to enter into negotiations and shall have the right to join in making the agreed charge."

MR. FRIEL: Yes, my lord, you will note that --

THE CHAIRMAN: This may be anticipating, but it

could save a great deal of discussion if you would tell me now whether both railways are agreed on your proposition?

MR. FRIEL: I think that that part of it which I just read is acceptable to our friends of the Canadian Pacific.

THE CHAIRMAN: That is then the new sub-section 1 of 35, you think?

MR. FRIEL: Well, I would say that they have given this a faint blessing. They have not shown the enthusiasm for it, my lord, that we have ourselves. Mr.Sinclair spoke to it.

THE CHAIRMAN: Perhaps we could hear from them as to what they have to say.

MR. FRIEL: He actually didn't have time to speak to it; he had to file it.

MR. SINCLAIR: It is on the record.

MR. FRIEL: It is on the record, however,

THE CHAIRMAN: That is one thing. Then in your new sub-section 2 you say that a duplicate of the agreement setting out the particulars of the agreed charge shall be filed with the Board within seven days after the date of the agreement, and the agreed charge shall become effective 30 days after the date of such filing. Now, what takes place within that period?

MR. FRIEL: Well, what would take place there, as far as other shippers are concerned, if they wanted to get in under the agreement quickly - -

THE CHAIRMAN: They must come within the thirty days?

MR. FRIEL: No, they don't have to come within the thirty days, but if they wanted to get in quickly --

THE CHAIRMAN: What is the object of the thirty days, then?

MR. FRIEL: Well, to give the public that much notice that there is an agreed charge in the making, and it is

there for them to do what they wish about it.

THE CHAIRMAN: I see.

MR. FRIEL: If they want to come in under it --

THE CHAIRMAN: So that any shipper who considers that his business would be unjustly discriminated against may come in then --

MR. FRIEL: Or later.

THE CHAIRMAN: Or later, and he is not precluded by that thirty days' period.

MR. FRIEL: No, my lord.

THE CHAIRMAN: I see. Now, the present sub-section 6 of the Act is exactly the same in its wording as this new sub-section 3 of yours, isn't it?

MR. FRIEL: I believe that is so, my lord.

THE CHAIRMAN: That is exactly the same. And the present sub-section 4 -- I mean, your proposed sub-section 4 seems to be the same, or is it the same? No.

MR. FRIEL: It is largely the same as the present sub-section 7.

THE CHAIRMAN: Yes, but it is not exactly the same.

MR. FRIEL: Just one change, my lord.

THE CHAIRMAN: The difference is that you have put "publish" instead of "approve".

MR. FRIEL: That is right, my lord.

THE CHAIRMAN: And that is consequent upon your other change?

MR. FRIEL: That is right. Everything else goes out except ---

THE CHAIRMAN: You strike out all the other sub-sections of 35?

MR. FRIEL: Yes, my lord, except one provision for a cancellation clause, giving either party the right to cancel the agreement upon specified notice.

THE CHAIRMAN: Where is that one now? You say that all agreed charges shall contain such a clause. Well, must they contain such a clause today?

MR. FRIEL: In practice they do. I just want to see that particular clause right here at the moment. No, it is provided now that the Board in fixing the charge -- no, that is in fixing the charge. Sub-section 4 of the present Section 35 provides that:

"The Board may approve an agreed charge either for such period as it thinks fit or without restriction of time, and the date on which the charge shall become operative, or as from which it shall be deemed to have become operative, shall be such date, not being earlier than the date on which application for approval was lodged, as may be fixed by the Board."

THE CHAIRMAN: Well, that disappears, doesn't it?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Well, is this last clause then of your amendment to sub-section 5 new? It seems to be.

MR. FRIEL: I am sorry, my lord, for the confusion here. I cannot find this particular provision in the Act. Perhaps it is not here, but in practice it is the common provision in agreed charge contracts now.

THE CHAIRMAN: I don't see what harm it can do whether it is in or not.

MR. FRIEL: But in practice there is a cancellation clause in all agreed charge contracts made now.

THE CHAIRMAN: I don't know whether there are any other important elements of the present law that you would change. You would have to examine the present act very carefully. What about all this rather elaborate provision of the present sub-section 9? Does that disappear?

MR. FRIEL: Yes, my lord, that is discussed in my notes.

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THE CHAIRMAN: Then you would leave it simply to Section 36 to operate?

MR. FRIEL: Yes, my lord. There is provision there for the shipper himself to get out a fixed charge. Then there is provision in Section 36 which provides for complaints by a representative body of carriers.

THE CHAIRMAN: Well all right, then.

MR. FRIEL: My next topic is:

UNIFORM ACCOUNTING AND RELATED PROBLEMS

The Canadian National's submission in respect to paragraph 2(d) of P.C.6033 are contained in its main submission, Exhibit 214, at pages 80 to 125.

There is a considerable degree of unanimity in all the submissions dealing with paragraph 2 (d) in so far as general principles are concerned, and it may be that this Commission will confine its deliberations in this respect to general principles. The divergence is in the matter of detail. There is general agreement that uniform accounting is desirable, that it should be made compulsory by statute, and that the method to be adopted should be

prescribed by the Board of Transport Commissioners. The Canadian National goes along with this. The Board would prescribe all the rules, would designate the property to be depreciated and would designate the methods and rates of depreciation. (Mr. Cooper, Vol. 100, p. 18767).

In the event that this Commission might decide to go beyond general principles in its recommendation, Canadian National has put forward its views in detail. It has submitted that a uniform system should be prescribed in accounting classifications to be issued by the Board of Transport Commissioners which, it is submitted, should be modelled after, and adhere^{to}/as closely as possible, the

Interstate Commerce Commission Classification. With this end in view, Canadian National has prepared a classification which has been filed in these proceedings as Exhibit 247. Its proposed classification contains the following:

(Page 24195 follows)

- (a) Investment in road and equipment
- (b) Operating revenues and operating expenses
- (c) Income and profit and loss accounts
- (d) General balance sheet accounts
- (e) Train miles, locomotive miles and car miles.

It also contains a memorandum of the difference between the proposed classification and those of the I.C.C.

The Canadian National considers that a classification modelled after that of the I.C.C. is preferable inasmuch as the I.C.C. Classifications have as their basis the knowledge and experience of railroad accounting gained over a long period of years by railroad accounting officers and by the I.C.C. By adopting a similar classification there would result uniformity as between the accounting regulations for Canadian railways and those for U.S.A. railways. The Canadian National System comprises and operates extensive lines of railways in the United States (see Exhibit 214, p. 81 and 82) and several of the United States railways operate lines in Canada. Both Canadian and United States railways would experience difficulties if they were required to maintain accounts in Canada different from those maintained in the United States. In addition, the Accounting Division of the Association of American Railroads, which is comprised of practically all the major railroads in North America, has liaison with the I.C.C. in the development and revision of accounting rules and classifications. Railway accounting problems and procedures are constantly under study by committees, as an outcome of which a large number of mandatory accounting rules and forms relating to transactions between railways have been adopted. Were such mandatory rules and forms not in effect, many complications and delays would arise in settlements between carriers,

especially in the matter of interline freight and passenger traffic. Inasmuch as there are forty-eight points at which the international traffic moves across the Canadian-United States border, the importance of such mandatory rules and forms cannot be exaggerated. Appeal and arbitration committees are the avenues through which differences of opinion are adjusted. It is therefore of importance that the rules imposed by the Board of Transport Commissioners should be similar. A liaison between the A.A.R. and the Board of Transport Commissioners, similar to that with the I.C.C., would logically follow and prove advantageous.

The major objective of uniformity in accounting is to achieve comparability as between railways. Comparisons of operating results and statistics between Canadian and U.S. railroads should be very useful. This is hardly possible without similarity of classifications.

SYSTEM CONSOLIDATED ACCOUNTS

The Canadian National publishes its balance sheet showing its assets and liabilities, and the income statement showing the results of operations, on a consolidated basis. It is the expressed will of Parliament that the railways, works and undertakings comprised in the System should be consolidated and operated as a national railway system (see preamble to Canadian National Railways Act, 1919, Chapter 13; The Canadian National-Canadian Pacific Act, 1933, Chapter 33 and amendments thereto---

COMMISSIONER INNIS: The C.P.R. are in the same position as the C.N.R. with regard to Americans and the United States, and would have the same advantages and---

MR FRIEL: Yes, my lord, we would maintain that.

THE CHAIRMAN: What is that first reference?

MR FRIEL: The first reference was to the Canadian National Railways Act, 1919, Chapter 13; the preamble appears there. The next reference is the C.N.-C.P. Act, 1933.

THE CHAIRMAN: There is no preamble to that, is there?

MR FRIEL: The preamble was dropped in the consolidation, my lord.

THE CHAIRMAN: What does it say?

MR FRIEL: Well, I have not got it here with me. It contains a recital that the system should be operated on a consolidated basis; that is one of the things in the preamble.

The other reference was the annual Canadian National Railways Financing and Guarantee Acts, of which there is one each year.

THE CHAIRMAN: What do they do? Do they carry preambles every year?

MR FRIEL: No. They too carry the authority for consolidating it and operating it on a system basis. Those accounts cover our annual appropriations, and they are on a system basis. They recognize that and nothing else.

The Consolidated Balance Sheet of the Canadian National Railway System shows the aggregate assets and liabilities under each balance sheet classification of all of the companies embraced within the System with all their inter-corporate relations eliminated in the same manner as if they were a single corporation (see Exhibit 214, p. 90 to 94).

It is impracticable for the Canadian National to keep its accounts otherwise than on a system basis. The Canadian National is opposed to any recommendation which

would effect any change in this method of keeping its accounts.

In connection with the question you asked me about the Canadian Pacific, my lord, while we think our system might have advantages over the Canadian Pacific, we would not make any recommendation that they be compelled to keep their accounts on the same basis.

THE CHAIRMAN: You are talking now of depreciation?

MR FRIEL: We are talking now of a consolidated system of accounting, of keeping system consolidated accounts. We keep our accounts as if we were just one company; theirs are separated.

THE CHAIRMAN: I see.

MR FRIEL: My next heading is

DEPRECIATION ACCOUNTING

This is dealt with in our Main Submission at pages 100 to 119.

The Canadian National submits that with respect to rolling stock there should be depreciation accounting, that it should be mandatory and that it should be on the straight line method.

THE CHAIRMAN: There you do depart from the Canadian Pacific, don't you?

MR FRIEL: Yes, my lord, we depart from them in respect of the method.

THE CHAIRMAN: Yes, but in two ways. You want the straight line method; that is, you not only want the right to retain it, but you want it made obligatory on all railways.

MR FRIEL: That is right, my lord.

In respect to roadway property, Canadian National will maintain, subject of course to an adverse

ruling, -- I mean, if the Board decides against us, well and good -- that there should be uniform accounting, but not depreciation accounting; that is in respect of roadway property. Mr. Cooper's evidence (Vol. 100, p. 18727).

In advocating the straight line method of depreciation for rolling stock, Canadian National is in disagreement with the Canadian Pacific in respect to the method to be adopted. Canadian Pacific advocates the user method. Mr. Cooper compares the two methods (Vol. 100, p. 18729 to 18735). His objections to the user method are that it minimizes the importance of the action of the elements, obsolescence and decay in causing exhaustion of service life, ignores the excess of normal maintenance and repairs caused by above normal use, and is difficult to apply and regulate. Mr. Cooper also stressed the fact that the user basis is not used by other railways. We heard a lot about that. On the other hand the I.C.C. prescribes the straight line method and the British Transport Commission has adopted the straight line method. There are two exhibits filed in this connection which should be of assistance in determining the relative value of the two methods: Exhibit 249 -- which is a Report of the Committee on Depreciation - National Association of Railroad and Utilities Commissioners -- referred to in Vol. 100, p. 18735-6; and Exhibit 278, which is a Report of the Special Committee (A.A.R. Accounting Division) on I.C.C. Bureau of Accounts and Cost Finding, Subject No. 424. Exhibit 278 is referred to in Vol. 115, p. 20942 and the conclusions of this Report appear at p. 20945-47.

In opposing depreciation accounting for roadway property the Canadian National is again in disagreement with the Canadian Pacific. The Canadian National follows retirement accounting on roadway property and the Canadian

Pacific follows roadway depreciation accounting on a user basis. British Railways have rejected depreciation accounting for roadway. The I.C.C. made depreciation accounting mandatory for roadway property (exclusive of track structure) in 1943, and on the straight line basis. The Canadian National's reasons for remaining on a retirement basis are given in Exhibit 214, p. 107 to 118. The reasons given, it is submitted, are equally applicable to the Canadian Pacific and demonstrate the advisability of eliminating roadway depreciation accounting for both railways in the best interests of the railways themselves in addition to uniformity. Canadian National submits that the adoption of depreciation accounting for roadway properties is an impossibility until there is available an inventory of property units and a determination of their costs (Exhibit 214, p. 118). The Canadian Pacific, while favouring uniformity, would make the method of depreciation optional. Nevertheless it, too, is satisfied to leave the matter of method to the Board of Transport Commissioners.

Mr. Cooper has suggested that the possibility should be explored of incorporation in the proposed Canadian classification replacement accounting in lieu of retirement accounting. Replacement accounting has been adopted by the British Transport Commission and, in Mr. Cooper's opinion, has great merit (Vol. 100, p. 18743).

RAILWAY AND NON-RAILWAY ITEMS

The non-rail operations in the Canadian National System consist of hotel operations and separately operated properties. While it may be said that all of these operations are ancillary to the main business of the Canadian National, the financial returns are excluded from railway operating revenues and expenses and reflected in separate accounts in the System income statement. These operations

are of minor importance when compared with the rail operations.

Canadian National's practice in respect to express traffic and telegraph operations differs from that of the Canadian Pacific. Canadian National includes both express and telegraphs in its railway operating revenues and expenses. The Canadian Pacific treats its telegraph operations and the money order side of its express operations as non-rail. Canadian National considers the income received on the securities of the Toronto Terminals Railway Company (The Canadian National and Canadian Pacific own this company jointly) as rail income. The Canadian Pacific treats its income on their securities as non-rail for rate making purposes. Mr. Cooper has given his opinion why such income should be treated as rail income (Vol. 100, p. 19083-86).

The Canadian National, while it believes that the segregation of assets, revenues and other income as between rail and non-rail items is a matter of detail to be settled by the regulatory authority, nevertheless, is satisfied that its practices in regard thereto are the correct accounting practices.

That is all I have to say on that topic, my lord.

My next topic is

CANADIAN NATIONAL - CANADIAN PACIFIC ACT

Canadian National has in its main Submission (Exhibit 214, p. 152-160) shown the status of co-operative projects under the C.N.-C.P. Act. There are seventeen projects in effect with an estimated annual joint saving of \$1,189,240. The greatest portion of this saving, \$972,000, results from passenger train pooling. Numerous other projects have been studied, some of which promised savings but for various reasons never became effective. The largest

project of this kind which had been agreed upon by the railways, consisting of line abandonments with an estimated annual joint saving of \$435,000, did not come into effect as the railways were unable to secure the necessary approval from the Board of Transport Commissioners.

The Canadian National considers that the C.N.-C.P. Act has served a very useful purpose and will continue to serve a useful purpose. Mr. Fairweather said (Vol. 117, p. 21208):

"One of the best features of that Act, in my judgment, is its negative aspect, where it gives each railway a protection against aggression without the necessity of leading this country into an extravaganza of competitive effort."

The C.N.-C.P. Act came into being in the depression and as a result of the depression. Conditions which aroused the country at that time to a sense of crisis in railway matters have largely passed. Traffic which during the depression had fallen disastrously is now at levels hardly thought possible then. Capacity then substantially unused is now substantially in full use. Line abandonments which were practical then would not be considered now. Mr. Fairweather, at p. 21258, referred to the case of the Bala-Wanup Line as such an example, and said:

"It would have been nothing short of disaster if that line had been abandoned."

Then again, Canada has grown rapidly in population, has developed immense natural resources and has increased its industrial output to a phenomenal degree and has become one of the greatest exporting countries in the world. Canada has assumed significance among nations in the world to an extent hardly dreamt of in the thirties. The country has largely grown up to the railways. The

result has been that the field of co-operation has narrowed. The Canadian Pacific says, in effect, that the field has narrowed to the vanishing point. There is a difference of opinion in this regard. Mr. Fairweather stated at p. 21191 that the field was still a large one and that substantial economies were possible. He said:

" . . . I believe that the field of co-operation is substantial enough to be very carefully explored and that it is one of the managerial fields ~~xxx~~ available to railways in meeting their present-day troubles."

The Canadian National does not ask for any change in the present Act and is opposed to any amendments of the nature proposed by the Canadian Federation of Agriculture (Vol. 40, p. 7536-37) or those of the Province of Manitoba (proposed Section 325A, subsection 3(c) Vol. 116, p. 21023).

Co-operation to be effective must be free and unfettered, otherwise it ceases to be co-operation. Its success is a matter of managerial judgment and ingenuity. A proper balance must be maintained between co-operation and competition both of which have their advantages. Management is constantly on the alert to effect economies and is not likely to pass up profitable co-operative projects. As your Lordship said (p. 21224):

"Can you easily imagine both railways sitting back and saying: 'We don't want to earn more remunerative operation, we don't want to save any money by economies.' You cannot imagine that?" It is worthwhile of note that Mr. J. J. Frawley, who supported both of the proposed amendments, replied:

"Oh, no, that is not to be imagined."

Manitoba's amendment would, I submit, add confusion and

delay to the hearings in revenue cases.

My next subject is

CARRYING HIS MAJESTY'S MAIL AND FORCES

Canadian National has dealt with the subject of His Majesty's mail and forces in its main Submission at pages 185-188 inclusive. It has proposed amendments to Section 351 of The Railway Act and Section 80 of the Post Office Act (both sections are set out in the main Submission), which would leave the determination of the terms and conditions and regulations for the carriage of mail and forces to the Board of Transport Commissioners instead of, as at present, to the Governor in Council.

Our proposed amendment is only short, and might be read into the record at this point. It is proposed that section 351 of the Railway Act be amended by substituting for the words "such regulations as the Governor in Council makes"---

THE CHAIRMAN: Just a moment; where is that?

MR FRIEL: Section 351 of the Railway Act.

COMMISSIONER INNIS: Does that parallel the Canadian Pacific?

MR FRIEL: There is a difference which I will explain, Dr. Innis.

(Page 24207 follows)

THE CHAIRMAN: Now, your proposed amendment to the Railway Act in this bound volume here begins with amending Section 259?

MR. FRIEL: That has to do with grade separation.

THE CHAIRMAN: Then it goes down to Section 264 but I have got nothing on 351.

MR. FRIEL: Well, it should be there, my lord.

THE CHAIRMAN: Yes, I have got it now. Now, just a moment.

MR. FRIEL: The last words in the section, my lord - the last two lines in the Section read:

"...on such terms and conditions and under such regulations as the Governor in Council makes."

We would change that, however, to add the words there:

"...such regulations as are made by the Board of Transport Commissioners."

and the change has the same effect in the Post Office Act, Section 80.

We say that the effect of the Canadian National amendments would make such carriage subject to such terms and conditions and under such regulations as are made by the Board of Transport Commissioners.

The Canadian Pacific has dealt with this same subject and have also proposed amendments to the same Sections (Vol. 128, pps. 23065-78). The Canadian Pacific amendments would leave the terms, conditions and regulations to be made by the Governor in Council but would add the words -

"Save that the terms and conditions as to the compensation to be paid to the company shall be such as may be determined from time to time by the Board of Transport Commissioners for Canada." (Vol.128,p.23074).

THE CHAIRMAN: Just a minute, please; I have not the Canadian Pacific Amendments here.

MR. FRIEL: They just add words to the Section.

THE CHAIRMAN: The last section they amend in this volume here is Section 325.

MR. FRIEL: At page 25 of their consolidation.

THE CHAIRMAN: Now, what is it they propose?

MR. FRIEL: They would add the words:

"....save that the terms and conditions as to the compensation to be paid to the company shall be such as may be determined from time to time by the Board of Transport Commissioners for Canada".

In other words, they would still leave everything to the Governor in Council except the matter of compensation and that would go to the Board.

Their proposals would remedy the main complaint of the railways if the Commission were satisfied to recommend their amendment.

THE CHAIRMAN: What I have here is an amendment which has marked upon it - "Canadian Pacific - Canadian National" as if you are in accord: -

"...on such terms and conditions and under such regulations as are made by the Governor-in-Council."

MR. FRIEL: Well, our amendment is different, my lord. We would take out "Governor in Council" and substitute "the Board of Transport Commissioners".

THE CHAIRMAN: This is the consolidation which was handed in by the Canadian Pacific Railway.

MR. FRIEL: I cannot imagine that they would have made a mistake in it.

THE CHAIRMAN: It says here that:

"This same shall....be carried on the railway,

and with the whole resources of the company if required, on such terms and conditions and under such regulations as the Governor in Council makes, save that the terms and conditions as to the compensation to be paid to the company shall be such as may be determined from time to time by the Board of Transport Commissioners for Canada." Then, you are in agreement, are you?

MR. FRIEL: We are in substantial agreement, my lord. The amendment that they propose meets our complaint. Mr. Carson has gone into the reasons for the amendment and there is no purpose to be served in reviewing them again. We are in full accord with his argument.

THE CHAIRMAN: Yes, I do not think there is any real difference of opinion.

MR. FRIEL: My next topic, my lord, is the Maritime Freight Rates Act, Section 6.

SECTION 6 - MARITIME FREIGHT RATES ACT

Mr. T. H. Cooper referred to Section 6 of the Maritime Freight Rates Act as being now a dead letter so far as separate accounts for Eastern Lines are concerned (Vol.98, p.18505).

THE CHAIRMAN: Is it doing any harm by its presence in the statute?

MR. FRIEL: It means that we are in breach of the statute year by year - that is all. It would merely regularize the present position.

THE CHAIRMAN: You would delete the whole of Section 6?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Have you looked into it to see whether anybody else might find it more convenient to keep it there?

MR. FRIEL: I cannot see that it makes the slightest

difference, my lord; in fact, it would be more convenient to everybody.

THE CHAIRMAN: I mean to the Government?

MR. FRIEL: Even the Government when meeting our deficit and the deficit we set up for the Eastern Lines makes two votes or one vote in two parts whereas one vote under the new arrangement would now take in the whole thing.

THE CHAIRMAN: Have you consulted the proper department about this?

MR. FRIEL: No, my lord.

MR. COVERT: My lord, I wrote to the Department of Finance.

THE CHAIRMAN: They have not much to say in answer?

MR. COVERT: No, my lord.

MR. FRIEL: Well, I said we were in breach of the statute. The accounts were kept separately under 1932 but were put back in the System accounts as a result of recommendations contained in the Duff Report (pages 17 and 18). Mr. Cooper said about it at page 18505:

"It (the Act) serves no purpose, it is a nuisance."

THE CHAIRMAN: Well, you are in breach of the Act?

MR. FRIEL: Yes, my lord.

THE CHAIRMAN: Well, we will not recommend that you should be indicted. Are you about to begin another subject?

MR. FRIEL: Yes, my lord. It is just a short one. I do not know if I have time to finish or not.

THE CHAIRMAN: How long will you take, Mr. Friel?

MR. FRIEL: I would only be about two minutes, my lord.

THE CHAIRMAN: Well, go ahead.

MR. FRIEL: My Lord, my other topic, I do not seem to have it so I am afraid I will have to take a few minutes on Monday morning. I will just be a few minutes Monday morning.

THE CHAIRMAN: Well, we will adjourn then until 10.30 Monday morning.

--The Commission adjourned at 4.10 p.m.
to meet again at 10.30 a.m. on Monday,
29th May, 1940.

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